VAT UPDATE
OCTOBER 2012

Covering material from July – September 2012

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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 reports the progress of appeals reappeared on 21 January 2011 after lying dormant for some time. It says that it will be updated monthly, but it appears to be less frequent or regular than that. The latest update appeared on 14 September 2012 after a gap since June.

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

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

Awaiting the CJEU:

- *Newey (t/a Ocean Finance)*: HMRC appealed to the Upper Tribunal after the First Tier Tribunal held that a scheme was effective in reducing irrecoverable VAT on advertising costs by moving a loan broking business to the Channel Islands (Upper Tribunal has referred questions to CJEU, Case C-653/11)
- *Bridport & West Dorset Golf Club Ltd*: the FTT decided that the UK's exemption for sporting services was not in compliance with the Directive; the UT has decided to refer questions to the CJEU, as reported in this update
- *GMAC UK plc*: HMRC appealed to the Upper Tribunal after the First Tier Tribunal held that the company was entitled to go back for many years in a bad debt relief claim because the UK rules were too restrictive – in a preliminary decision, the UT decided not to refer questions to the CJEU but to proceed with a substantive hearing; one

issue now seems likely to be referred to the CJEU (covered in this update)

UK appeals awaiting hearing (or announcement of decision):

- *Croall Bryson & Co Ltd*: HMRC are appealing to the Upper Tribunal after the First-Tier Tribunal decided a car dealer was entitled to zero-rate supplies to wheelchair users on the basis of the evidence obtained (hearing date to be confirmed)
- *David Finnamore t/a Hanbridge Storage Services*: HMRC have been granted leave to appeal to Upper Tribunal after First-Tier decided that a trader was supplying a licence to occupy land rather than storage services – hearing date to be confirmed
- *DCM (Optical Holdings) Ltd*: HMRC have appealed to the Upper Tribunal after the FTT accepted that a floor-area based special method could be appropriate (Upper Tribunal hearing was previously stated as 20 – 23 September 2011, but it now says "date to be confirmed")
- *Esporta Ltd*: HMRC have been granted leave to appeal to the Upper Tribunal after the First-Tier Tribunal decided that sports club subscriptions paid in respect of a notice period were not taxable because the club did not make its facilities available to the members during that period (hearing scheduled for December 2012)
- *European Tour Operators Association*: HMRC have appealed against FTT decision that association was allowed to exempt its subscriptions (hearing was May 2012 – decision awaited)
- *Honourable Society of Middle Temple*: HMRC have been granted leave to appeal to the Upper Tribunal against the FTT decision that the Society was making separate zero-rated supplies of water as well as taxable land – hearing date to be confirmed
- *John Wilkins Ltd and others*: Supreme Court refused HMRC permission to appeal one aspect of the case, in which the Court of Appeal decided that motor dealers were entitled in principle to claim compound interest on VAT repayments. Substantive issue stayed pending the *Littlewoods* decision in the CJEU (will presumably now be addressed)
- *SecretHotels2 Ltd*: HMRC have been granted leave to appeal to the Court of Appeal against the Upper Tribunal decision that a website operator was acting as an agent, not as a principal, in selling hotel accommodation to tourists (hearing 3 – 4 July 2012 – decision not yet released)
- *Simpson & Marwick*: HMRC have been granted leave to appeal to the Court of Session against the Upper Tribunal's decision that bad debt relief could be claimed for the full amount of "VAT-only" invoices, rather than only the VAT fraction of them (where the invoice for the net supply had been paid by an insurance company)
- *Total Technology (Engineering) Ltd*: HMRC have appealed to the Upper Tribunal after the First-Tier Tribunal decided that a default surcharge was "disproportionate" (hearing was July 2012, decision awaited)

- *The British Disabled Flying Association*: HMRC are seeking permission to appeal to the Upper Tribunal after the First-Tier Tribunal decided supplies of adapted aircraft were eligible for zero-rating – FTT refused leave to appeal, so HMRC have applied directly to the UT
- *UK Storage Company (SW) Ltd*: HMRC have appealed to appeal to Upper Tribunal after First-Tier decided that a trader was supplying a licence to occupy land rather than storage services (hearing was July 2012, decision awaited)
- *Wrag Barn Golf and Country Club*: dispute about whether a partnership had opted land and later admitted different members, or whether a different partnership disposed of the land and was therefore not bound by the option – FTT found for HMRC (bound); UT referred back for reconsideration; HMRC have been granted permission to appeal to the CA

In this update from previous lists:

- *Littlewoods/Grattan*: the entitlement of traders to interest on VAT overpayments (CJEU decision to be referred back to national court).

The HMRC list also mentions *Robinson Family Ltd* (see 2.12.1). They have decided not to appeal the FTT decision reported in this update, and are considering whether it will be necessary to issue a R & C Brief.

2. OUTPUTS

2.1 Scope of VAT: linking supplies to consideration

2.1.1 Taxable activity?

An individual made 12 supplies of timber in April 2005, and 25 further similar transactions from May 2005 to December 2006. When the Latvian tax authorities carried out an enquiry, they formed the view that he should have registered for VAT, and imposed a penalty (as well as assessing to collect the unpaid tax). He appealed, claiming that the sales of timber were not "economic activity" because they were neither systematic nor independent. He also argued that the penalty (at 18% of the value of the supplies – i.e. 100% of the VAT) was "disproportionate".

The trees had been felled following a storm. The forestry authority had issued a report saying that they were too young to be felled in the ordinary course of forestry management. The individual argued that he had bought the forest for his personal use and the sale of the timber was incidental to that, and was brought about by "force majeure" (i.e. something imposed outside his control). Questions were referred to the CJEU.

The Court responded that an activity which involved sales of timber, whether through force majeure or not, would constitute economic activity if it was "exploitation of property for the purpose of obtaining income on a continuing basis." It was for the national court to consider all the circumstances and conclude whether this definition was met.

The Court also ruled that it was possible for a penalty of 100% of the VAT to be disproportionate. Once again, it was for the national court to determine whether the amount of the penalty went further than was necessary to attain the objectives of ensuring the correct levying and collection of the tax and preventing fraud. It should have regard to the facts of the case, including the sum actually imposed and the possible existence of fraud or avoidance by the individual concerned. Presumably if the national court decides that the activity is not economic anyway, the penalty will be cancelled.

CJEU (Case C-263/11): *Redlihs v Valsts ienemumu dienests*

2.1.2 Consideration not received

A Spanish company ran VAT-exempt gaming activities and some taxable activities. In calculating its deductible input tax, it excluded from its exempt turnover the proportion of the price of bingo cards which was reserved for prizes. This proportion was set by law. The Spanish tax authority ruled that the whole price of the bingo card was turnover received by the company; none of it was chargeable to output tax, but it was all exempt income which had to be taken into account for the recovery of input tax.

The CJEU agreed with the company. Because the prize percentage was legally prescribed, the company could not freely make use of that part of the money received. It was similar to the *Glawe Spiel* case in which the prize fund was mechanically separated by the gaming machine: the company should not be treated as "receiving" that part of the money. The situation was different from that in *Town & County Factors*, because there

the prize fund was at the discretion of the company rather than a legal requirement.

CJEU (Case C-377/11): *International Bingo Technology, S.A. v Tribunal Económico Administrativo Regional de Cataluña (TEARC)*

2.1.3 Grants or consideration?

A charity, established as a limited company, accounted for output tax on certain receipts of money. It then made two voluntary disclosures, claiming that the receipts were grants that did not constitute consideration for any supply. HMRC paid the first repayment claim (£5,500), but then assessed to recover it and refused to pay the second (£37,560). The charity appealed against the assessment and the refusal.

The charity carried out various projects for local authorities and quasi-governmental agencies. It asked for a ruling from HMRC on the liability of the payments it received for this work, and was told that it was VATable. However, not all of the documentation for all of its activities was provided to HMRC, and discussions continued following a VAT inspection in 2006.

The charity made the first voluntary disclosure on 25 February 2009, relating to the period ending February 2006. It did not specify which activities were regarded as outside the scope, but was nevertheless paid by HMRC on 9 March 2009. HMRC subsequently claimed that this was "a mistake". The second voluntary disclosure was submitted in April 2009, relating to the periods from May 2006 to August 2008. HMRC appeared now to realise what was being argued, raised the assessment and refused the repayment; the charity appealed, and over the next few years was required to provide much more information about the projects concerned, who benefited from them and who paid for them. The matter finally came before the Tribunal in February 2012.

The Tribunal examined the evidence in relation to a total of 13 projects and concluded that HMRC's decisions were correct. There was a direct link between the provision of the money and the work done: they were services supplied for consideration. Both the appeals were dismissed.

First Tier Tribunal (TC02175): *Hope in the Community Ltd*

2.2 Disbursements

Nothing to report.

2.3 Exemptions

2.3.1 Portfolio management

The German Federal Finance Court referred questions to the CJEU on whether discretionary portfolio management for individuals (where the manager has powers to take investment decisions without reference to the client) should be exempt from VAT.

Note that the case started before the VAT package changes to the Principal Directive took effect on 1 January 2010. The provisions of art.56(1)(e) are now in art.59(1)(e). The questions were:

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

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

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

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

The services which, according to the second question, might be compounded or separated for VAT purposes, were described as:

(a) deciding, on the basis of expert knowledge and observation of the markets, what securities should be bought or sold, and when;

(b) implementing those decisions by actually buying and selling the securities; and

(c) a series of more administrative services connected with holding the securities.

The appellant and tax authority were agreed that the funds in question were not 'special investment funds' for the purposes of the Directive. The Advocate-General (Sharpston) defines such funds as '*joint funds, in which many investments are pooled and spread over a range of securities which can be managed effectively in order to optimise results, and in which individual investments may be relatively modest; such funds manage their investments in their own name and on their own behalf, while each*

investor owns a share (one or more units) of the fund but not the fund's investments as such'.

Advocate-General Sharpston gave an opinion that:

- while the listed services (a) and (b) are capable of being sold separately, a customer who asks a portfolio manager to do both clearly regards them as a single supply, and (c) is ancillary to that supply;
- portfolio management services do not qualify for exemption under art.135, which must be narrowly construed – the combination of (a) and (b) is mainly the provision of expertise in choosing investments, rather than 'negotiation' of transactions as referred to in that article and as interpreted by precedent cases;
- although they compete to some extent with exempt management of special investment funds, different treatment is acceptable where it is explicitly provided for by the Directive;
- 'banking, financial and insurance transactions' in art.56 is not to be narrowly construed, so such services provided to persons belonging outside the EU are outside the scope of EU VAT. Presumably they would give rise to input tax deduction because the first conclusion was that they would have been taxable if the place of supply had been Germany.

The opinion accepted that it is possible (as argued by the bank and the Commission) to regard the principal element of the supply as the execution of the transactions in accordance with an agreed investment strategy; however, she did not agree with that view. She also considered whether the Directive explains the purpose of the exemption in art.135(1)(f), and concluded that it does not.

The full Court has followed the opinion. The short answers to the questions are:

1. A securities-based assets management service, such as that at issue in the main proceedings, namely where a taxable person for remuneration and on the basis of his own discretion takes decisions on the purchase and sale of securities and implements those decisions by buying and selling the securities, consists of two elements which are so closely linked that they form, objectively, a single economic supply.

2. Article 135(1)(f) or (g) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax must be interpreted as meaning that securities-based asset management, such as that at issue in the main proceedings, is not exempt from value added tax under that provision.

3. Article 56(1)(e) of Directive 2006/112 must be interpreted as covering not only the services referred to in Article 135(1)(a) to (g) of Directive 2006/112, but also securities-based assets management services.

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

2.3.2 Retail distribution review

HMRC have published their internal guidance on the treatment of fees received by insurance and financial services intermediaries following the introduction of the Retail Distribution Review with effect from 1 January 2013. The financial services regulations are being changed so that far fewer, if any, intermediary services will be remunerated by commission from the investment or finance provider. Instead, the intermediary will charge a fee to the client. This is explained by HMRC at VATINS5312:

The new rules require advisers to move from receiving commissions to fees agreed with customers in respect of all Retail Investment Products as defined by the FSA, which are:

1. *a life policy; or*
2. *a unit; or*
3. *a stakeholder pension scheme; or*
4. *a personal pension scheme; or*
5. *an interest in an investment trust savings scheme; or*
6. *a security in an investment trust; or*
7. *any other designated investment which offers exposure to underlying financial assets, in a packaged form which modifies that exposure when compared with a direct holding in the financial asset; or*
8. *a structured capital-at-risk product*

whether or not any of a to h are held within an ISA or CTF.

In the past, most independent financial advisers have been able to ignore the question of the true liability of their supplies, because the great majority of their income would clearly be exempt under either Group 2 or Group 5 Sch.9 VATA 1994. In general, the way in which the remuneration was received was regarded as a short-cut to the VAT treatment: commission was clearly for arranging a transaction and was therefore exempt, while a fee paid by a client might be exempt or it might be taxable. Although there was a possibility that a particular supply might constitute VATable advice rather than exempt intermediation, the total of such fees would be unlikely in a small firm to reach the registration threshold in a year. Services were therefore either exempt or outside the scope, and it was not particularly important which was which.

Where an IFA charges a fee to the client, there is at least a stronger impression that the service might be VATable advice. As the total of fees will rise and commissions will fall, it becomes necessary to determine more accurately whether the conditions for exemption are met in relation to any particular fee, and to make sure that the invoice correctly describes the service rendered.

HMRC's guidance recognises that the liability of the supply depends on the nature of the work, not how it is remunerated. Where a particular service was properly regarded as exempt before the introduction of RDR, it will still be exempt afterwards, even if the intermediary charges a fee. The internal manual contains the following advice on what will be regarded as properly exempt (VATINS5313 – 5314):

Advice

It is important when considering the VAT treatment of services in this area to understand the meaning of 'advice' for regulatory purposes. From a VAT perspective general financial advice is not synonymous with the term 'advice' for the purposes of the RDR rules. The RDR is primarily concerned with the distribution (i.e. sale) of financial products to the retail market. The RDR's focus is ensuring that there is no hidden bias in product recommendations by ensuring that intermediaries (termed 'advisers') clearly disclose the nature of their service and set the level of their charges by reference to the amount of work done rather than being motivated by the level of fee associated with a particular product type or product provider.

The term 'advice' under RDR thus covers a broad range of functions including primarily recommendation, referral and intermediary work around product distribution which would continue to be VAT exempt under general principles. General financial advice would continue to be taxable in the same way.

Services of an adviser

An adviser's role in the retail investment market will normally involve them entering into arrangements with the customer under which they might:

1. *gather information about the customer (fact find)*
2. *carry out research to find suitable investment options*
3. *provide the customer with reports, financial health-checks, forecasts*
4. *recommend specific investment products to the customer, including the prices at which these can be arranged*
5. *act between the product provider(s) and the customer with a view to arranging the sale of the Retail Investment Products agreed with the customer*
6. *and, where applicable, i.e. where the customer agrees to an ongoing review service, monitor the customer's ongoing position to ensure that the products continue to meet the requirements of the customer*

Where the customer is seeking the arrangements of a Retail Investment Product and the adviser performs the arrangements as outlined at stage 5 above, (regardless of whether the sale of the product is finally concluded): and is able to evidence that they have done so; the services in stage 1 – 6, which fall within the agreement concluded with the customer, will be VAT exempt.

Where there is no evidence of such product arrangement services or where one or more of the stages are contracted for under a separate agreement, so that the service provided to the customer is that of general advice or recommendation only, any charges to the customer will carry VAT at the standard rate.

The VAT liability depends on what is done by the adviser and it makes no difference whether a fee is levied up front or over the life of a product (as for example with Regular Contribution products).

Ongoing services

If, after the arrangements of the sale of Retail Investment Products, the customer signs up to ongoing review services, some or all of the process may occur again. The adviser should be able to determine and evidence where they are in the process with that customer. The VAT liability of ongoing services will depend upon the services the customer has agreed the adviser should perform, as outlined above.

Evidence

Without prejudice to the general VAT evidential requirements, an adviser will need to keep sufficient evidence to support the tax treatment applied to the services supplied. This evidence will need to be specific to the services performed for the customer and demonstrate that the adviser acted between the customer and the product provider with a view to arranging the sale of Retail Investment Products. If an adviser is unable to provide evidence that an exempt supply has taken place, VAT will be due on that supply.

There is separate RDR guidance in the Financial Services section in relation to acting as an intermediary on financial products, but it is essentially the same as the insurance guidance. The draft guidance, which was the subject of consultation last year, dealt with both sides together. It is noticeable that the draft guidance also included an extra step in the list of services: that of "rebalancing a portfolio", which might be regarded as exempt execution of an initial investment instruction rather than taxable management. This concept appears to have been removed altogether and cannot easily be found in the HMRC guidance under any heading.

www.hmrc.gov.uk: VATINS5311 – 5315; VATFIN7650ff.

2.3.3 New collective investment vehicle

The government is introducing a new tax-transparent collective investment fund vehicle. "Transparency" means that the investor (e.g. a member of the public) will be taxed on income and gains as they arise in the hands of the fund manager, even though the legal owner of the investments is the manager. Open-ended investment companies are transparent for taxation of income but not for CGT on gains; other forms of investment are not transparent at all, which may have a significant effect on the timing and nature of tax charges on investment returns.

The government has run a consultation on draft regulations to deal with the new investment product, including changes to Group 5 Sch.9 VATA 1994 to extend exemption to management of "authorised contractual schemes" which are to be introduced by amendments to the Financial Services and Markets Act 2000 (and defined in s.237 of that Act).

The draft regulations suggest that they will be implemented before the end of 2012, with the new investments available under the law on 1 January 2013. Investment managers may take longer to provide the products.

www.hmrc.gov.uk/drafts/draft-vat-order-jul2012.pdf

2.3.4 Education, education

In February 2010, a commercial education provider submitted a voluntary disclosure claiming a repayment of output tax amounting to £62,000. It appealed against HMRC's refusal of the claim, and applied for leave to appeal out of time against a refusal of an earlier voluntary disclosure for £400,000 which had been made in March 2009. This was apparently a claim for all output tax ever accounted for, without adjustment for any input tax. The college did not provide any detailed computations to back up the claim, explaining that for various reasons its records were not available.

HMRC accepted that some of the college's supplies were "Teaching English as a Foreign Language", and allowed the claim to that extent. However, it did not accept that the rest of the supplies were made in the capacity of an "eligible body". The Tribunal agreed that it did not fall within the definition of a school within the meaning of the Education Act 1996, or a college, institution, school or hall of a UK university. The factors considered in the *School of Finance and Management* case were considered and did not appear to tip the balance in favour of the claim.

First Tier Tribunal (TC02256): *Westminster College of Computing Ltd*

The Polish court has referred questions to the CJEU on whether it is permissible for a Member State to extend the education exemption to commercial organisations which are governed by private law. The second part of the question suggests that the appellant in the case wants to "have it both ways" – exempting outputs and deducting input tax. That seems an unlikely conclusion.

Should point (i) of Article 132(1), Article 133 and Article 134 of [the Principal VAT Directive] be interpreted as precluding exemption from value added tax of educational services provided for commercial purposes by bodies not governed by public law which follows from Article 43(1)(1) of the [Polish law] in the version in force in 2010?

If the answer to the first question is in the affirmative, does this mean that due to the incompatibility of the exemption with the provisions of Directive 2006/112, Article 168 of the directive grants taxpayers both the right to apply the tax exemption and to deduct input VAT?

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

Apparently by coincidence, HMRC have issued a consultation document to examine options for extending the education exemption to commercial providers of higher education. The stated aim is to "facilitate a more competitive HE sector that offers greater student choice and is responsive to student demand."

The proposals include setting a new definition of "higher education" which would be used to extend the exemption. Bodies providing courses that lead to a degree or count towards a degree or postgraduate diploma would become "eligible bodies". Two options for the new eligible body status are proposed for discussion, along with many details of the proposal.

http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_ConsultationDocuments&propertyType=document&columns=1&id=HMCE_PROD1_032304

2.3.5 Welfare exemption

Germany imposes conditions on the availability of the exemption for welfare services, including the requirement 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. Questions were referred to the CJEU to determine whether this condition was permitted under the Directive.

Following a detailed consideration of a range of precedent cases, Advocate-General Mazak has given an opinion that the German rules infringed the principle of fiscal neutrality. Certain charitable organisations, which were subject to private rather than public law, were not subject to the condition about public funding, while providing essentially similar services to the appellant in the case (who did not meet the condition, because some 68% of her clients paid their own bills). The German government argued that its laws put charitable organisations on the same non-taxable footing as public bodies; the Advocate-General did not accept that this was a good enough reason to treat the same supplies differently.

On the other hand, the opinion found that the general principle of restricting the exemption to cases which were partly funded by social security lay within the discretion available to member states.

It is interesting to note that the wording of the Directive (in art.13(A)(2)(a) of the 6th Directive, because the dispute dated from the 1990s) provides the following:

Member States may make the granting to bodies other than those governed by public law of each exemption provided for in (1)(b), (g), (h), (i), (l), (m) and (n) of this Article subject in each individual case to one or more of the following conditions:

– they shall not systematically aim to make a profit, but any profits nevertheless arising shall not be distributed, but shall be assigned to the continuance or improvement of the services supplied,

– they shall be managed and administered on an essentially voluntary basis by persons who have no direct or indirect interest, either themselves or through intermediaries, in the results of the activities concerned,

– they shall charge prices approved by the public authorities or which do not exceed such approved prices or, in respect of those services not subject to approval, prices lower than those charged for similar services by commercial enterprises subject to [VAT],

– exemption of the services concerned shall not be likely to create distortions of competition such as to place at a disadvantage commercial enterprises liable to [VAT]

The reference to distortion of competition appears to suggest that the problem lies with the exemption being granted to the charities, rather than not being granted to the appellant.

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

2.3.6 Sporting fees referred to CJEU

The Upper Tribunal has decided to refer questions to the Court of Justice in the *Bridport and West Dorset Golf Club* case.

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

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

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

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

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

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

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

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

HMRC appealed to the Upper Tribunal, where Mrs Justice Proudman considered that a reference to the CJEU was appropriate. The interpretation of the Directive was not clear, and the matter was of importance throughout the EU. The questions will deal with the interpretation of both articles 133(d) and 134(b).

The club argued that the matter was "acte clair" (i.e. obvious from precedent decisions) and therefore should not be referred. The judge disagreed, considering that the interaction of the rule on distortion of competition and the interpretation of the expression "additional income" had not been considered before.

The parties were invited to co-operate in drafting the questions for reference, which will be submitted to Mrs Justice Proudman for approval.

Upper Tribunal: *HMRC v The Bridport and West Dorset Golf Club Ltd*

HMRC have announced that they will not be paying other claims already made, nor inviting any new claims to be made, pending the CJEU's decision. They do not expect this to be handed down until the summer of 2013 at the earliest.

R & C Brief 25/2012

Meanwhile, a number of other clubs have failed in a different attempt to claim the exemption. They accounted for VAT on income from 1973 onwards, and made voluntary disclosures that fell into two categories:

- members' clubs claimed that their subscriptions represented multiple supplies which were variously exempt, zero-rated and standard rated, rather than a single supply, and exemption applied to income before 1990 (HMRC had repaid VAT for periods from 1990 onwards);
- proprietary clubs claimed the benefit of the exemption in relation to their income from 1990 onwards, either on the basis that a single exempt supply had been made, or else on the basis that mixed supplies had been made some of which were exempt.

HMRC argued that a transitional provision allowed the UK to continue to tax certain transactions that were exempt under the 6th Directive. The relevant provision was abolished with effect from 1 January 1990, whereupon the sporting exemption applied without the possibility of a derogation. The exemption was not incorporated into UK law until 1994, when HMRC allowed affected bodies to make a retrospective claim to 1990.

The members' clubs argued that their income up to 1990 had consisted of a number of supplies:

(1) the right to play golf (standard rated prior to 1 January 1990);

(2) golf union fees such as fees for individual membership of Golf England and relevant county associations (said to be a disbursement or outside the scope of VAT);

(3) the supply of credit where members pay by instalments (said to be exempt from VAT);

(4) the right to play in club competitions (said to be exempt from VAT);

(5) the opportunity to hire club rooms (said to be exempt from VAT or outside the scope);

(6) various publications including newsletters, handbooks and magazines (said to be zero rated).

It was acknowledged that these had been treated as a single exempt supply since 1990, and if the retrospective claim was upheld, there would be consequences for the future and any year that was still in time for assessment; nevertheless the claim was made and should be considered on its merits.

The two proprietary clubs made claims on slightly different bases, but they included the argument that the UK's implementation of the Directive contravened the principle of fiscal neutrality. Because the competing members' clubs were exempt, the proprietary clubs should also be exempt.

The Tribunal examined the case law on the issue of compound and multiple supplies, starting with *CPP* and working through *Levob* to more recent cases such as *Purple Parking*. Although the club's counsel made some points of principle with which the Tribunal agreed, overall it still found that the subscription represented a single supply which it would be artificial to split. This was properly treated as taxable under the transitional provision up to 1990, and properly treated as exempt when made by an eligible body after 1990.

The Tribunal accepted that the UK's rules produced a distortion of competition which weighed against the proprietary clubs. However, it was persuaded by numerous CJEU precedents that such a distortion was recognised by the Directive and by the court as lawful and within the purpose of the exemption.

All the appeals were therefore dismissed, apart from a possible residual issue in relation to golf union fees. These might properly be treated as disbursements outside the scope of VAT, but the Tribunal considered that the evidence was not sufficiently clear to draw a firm conclusion. Any party which wished to take this issue further should provide further information within 56 days.

First Tier Tribunal (TC02234): *Chipping Sodbury Golf Club and related appeals*

2.3.7 Cost sharing

HMRC have published guidance on the operation of the new Sch.9 Group 16 exemption for supplies within cost-sharing groups as an Information Sheet. This is very detailed and covers the following 59 points:

1. Introduction – what is the Cost Sharing Exemption?

2. Does the exemption apply to supplies of goods?

3. What is meant by 'members' of a CSG?

4. When does the exemption apply?

5. What are the conditions of the exemption?

6. Does the exemption apply to commercial outsourced services?

7. Can a CSG make supplies to non-members?

8. What types of businesses and organisations can benefit from the exemption?

9. When did the exemption become effective in UK legislation?

10. What is the new Group 16 to Schedule 9 of the VAT Act 1994?

General provisions

11. Are all supplies made by a CSG covered by the exemption?

12. Does the exemption apply in any other circumstances?

13. What about supplies to a CSG?

14. What are the normal VAT rules regarding transfers/supplies of staff?

15. Can a CSG benefit from the normal VAT Reliefs and special provisions?

16. Can a UK established CSG have members in other Member States (OMS) and can a UK business or organisation belong to a CSG established in OMS?

17. Do the normal place of supply rules apply?

18. What is the input tax treatment in relation to supplies to overseas customers?

19. What does this mean in relation to supplies received by a UK member of a CSG based in another Member State?

20. Do EU Procurement Directives apply?

How the conditions are to be interpreted

Independent group of persons

21. What is a Cost Sharing Group (CSG)?

22. Must the CSG be separate from its members?

Some particular forms of CSG

23. Partnerships have to be for profit, can they be CSG's as a CSG can only seek 'an exact reimbursement of costs'?

24. What about the different legal status of partnerships in Scotland and the rest of the UK?

25. What about limited partnerships?

26. Can unincorporated associations be CSGs?

27. Can a CSG be a charity?

Number of members and memberships

28. Are there any limits on the number of members a CSG can have?

29. What must a CSG consider when recruiting members?

30. Who is responsible for the CSG's VAT affairs – the members or the CSG?

31. Will HMRC put any special process or compliance arrangements in place?

32. Must all members of a CSG receive Group 16 supplies?

33. What are 'qualifying supplies'?

34. What happens if a member of the CSG ceases to receive 'qualifying supplies'?

35. Must all members receive the same type and volume of qualifying supplies?

Exempt and/or non-business activities

36. Do all members have to have exempt and/or non-business activities?

37. Can businesses and organisations that are not VAT registered join CSGs?

38. What are exempt supplies?

'Directly necessary' services

39. What are 'directly necessary' services?

40. How may directly necessary services be identified?

41. How does the 85 per cent directly necessary test work?

42. How can the test be applied in practice?

43. What will happen if a member meets the 85 per cent test by having an intention to make 85 per cent or more exempt and/or non-business supplies in the following 12 month period but that intention does not materialise?

44. What happens if a member fails the 85 per cent test after initially meeting the test?

45. Can the 85 per cent test be applied on a sector/account basis?

'Direct reimbursement of costs'?

46. What is meant by 'direct reimbursement of costs'?

47. What is the position if the CSG needs to raise funds?

48. How are charges for management and similar services to be treated?

49. What is transfer pricing and does it apply to services supplied by a CSG to its members?

50. If the direct tax transfer pricing rules apply will they preclude use of the exemption as affected transactions may not comply with the 'exact reimbursement of costs' rule?

‘Distortion of competition’?

51. How can the exemption lead to a ‘distortion of competition’?

52. What does the ECJ case of Taksatorringen (C-8/01) comment on the ‘distortion of competition’ point?

53. What are the practical implications of the Taksatorringen case?

54. What is the position when a commercial operator supplies a CSG?

CSGs and VAT groups

55. Can a VAT Group Registration be a member of a CSG?

56. Can a CSG be a member of a VAT group?

57. How do CSGs and VAT groups interact in practice?

58. How is the 5 per cent test applied to a VAT group member?

59. How is the 85 per cent ‘directly necessary’ test applied to a VAT group member?

R&C Brief 23/2012; Information Sheet 7/2012

2.4 Zero-rating

2.4.1 Borderline anomalies

HMRC have issued a Brief summarising the publication of seven information sheets about the “borderline anomalies” which were supposed to be addressed by the 2012 Budget. The guidance explains where the rules have ended up after the consultation, public objections and amendment of the original proposals.

R & C Brief 27/2012

The Information Sheet on “hot food and premises” explains that the treatment of hot takeaway food should be made more consistent by the addition of five “objective” tests to the existing condition about the purpose for which food has been heated. It will still be necessary for the food to be hot at the time it is provided, and the five tests are:

Test 1: It has been heated for the purposes of enabling it to be consumed hot (ie the current test).

Test 2: It has been heated to order.

Test 3: It has been kept hot after being heated.

Test 4: It is provided to a customer in packaging that retains heat (whether or not the packaging was primarily designed for that purpose) or in any other packaging that is specifically designed for hot food.

Test 5: It is advertised or marketed in a way that indicates that it is supplied hot.

Further detailed guidance is given about how to apply the tests, together with long lists of examples of food that is likely to be caught by each one. The following is an example of something that may not be caught:

Example 4: A retailer sells a Cornish pasty that has been baked off and then left to cool naturally but is still hot at the time that it is provided to a customer (and so the precondition is satisfied). However, the retailer does not intend that the pasty will be consumed hot by the customer (Test 1 is not met); it has not been cooked to order (Test 2 is not met); it has not been kept hot after being cooked (Test 3 is not met); it has been provided to the customer in a standard paper bag (Test 4 is not met) and it is advertised as “freshly baked” (Test 5 is not met). As none of the tests are satisfied, the sale of the pasties is zero-rated.

The Information Sheet also gives further details about the new definition of “premises” for the purpose of applying the definition of “catering”. This does not appear to contradict the *Compass Contract Services* case (where it was held that the whole BBC site was not “the premises” for catering outlets within that site); the following examples are given of what will not be covered.

The definition of premises does not include areas with tables and chairs available for general use by members of the public who are not customers of one or more food retailers. Examples include:

- *benches in shopping centres designed as general seating for customers to rest or wait*

- *tables and chairs in a public picnic area – for example, picnic benches by a motorway service station where people can eat sandwiches that they have prepared themselves (as well as ones that they have been purchased from the service station), and where the area is not regularly cleaned and cleared by the retailer or landlord and*
- *seating areas in airport lounges and railway stations where customers wait for their planes and trains.*

Information Sheet 12/2012

The Information Sheet on sports nutrition drinks is much shorter, presumably because the rules are simpler and are unlikely to change the treatment of many products. The rules are explained in detail.

Information Sheet 15/2012

2.4.2 Pet food

A manufacturer of food for dogs treated a number of products as standard rated. In 2009 the company submitted a repayment claim for nearly £7m in respect of sales of 5 products between 1980 and January 2009, arguing that they constituted food for "working dogs" rather than pets, and should therefore have been zero-rated.

The director of the company gave evidence that the products were developed with working dogs in mind: he had seen this as a niche market in which the company might build a successful business. The suitability of the products for working dogs was examined by the Tribunal, as well as the way in which they were advertised and held out for sale.

The products were clearly "animal feeding stuffs" within Group 1 Sch.8 VATA 1994; the legal argument concerned whether they fell within the excepted items as either "pet foods, packaged or prepared" or "meal for dogs".

The Tribunal considered the meaning of the word "pet", and concluded that most dogs in the UK are pets – but that gundogs, prison dogs, farm dogs and other working dogs are not within the definition. The Tribunal also considered whether HMRC's public guidance was relevant – the appellant complained that it had been misleading, and if it had correctly reflected other Tribunal decisions, the company would have been better able to make sure that its products qualified for zero-rating.

The Tribunal concluded that meeting the conditions depended on the subjective intention of the supplier, objectively determined (the intention of the purchaser being here irrelevant). Based on the history of the products, four of which had been phased out and replaced with other food that was specifically marketed as for working dogs, the Tribunal concluded that the intention in relation to those four lines was not to sell pet food.

A further detailed examination was made of the expression "meal for dogs". The chairman decided that it meant "a mixer for use with meat or canned dog food made primarily from wheat flour with other ingredients and baked; and in particular made from the same or similar ingredients to a dog biscuit and baked in the same way but crumbled or broken up rather than cut into shapes", and these products did not fit that description.

Accordingly, the appeal was allowed in respect of the four products that were discontinued, but dismissed in relation to the fifth product that had apparently been marketed as suitable for all dogs.

First Tier Tribunal (TC02201): *Roger Skinner Ltd*

2.4.3 Updated manual

HMRC have updated their online manual on VAT relief for books to include the revised position on photobooks following the *Harrier LLC* decision.

www.hmrc.gov.uk/manuals/vbooksmanual/updates/vbooksupdate090712.htm

2.5 Lower rate

2.5.1 Static caravans

HMRC have issued an Information Sheet explaining in detail the changes to the tax treatment of static caravans. The rules from 6 April 2013 will be:

(a) The sale of a caravan will be standard-rated if it does not exceed 7 m in length and 2.55 m in width, as with the current rules.

(b) The sale of a caravan will be reduced-rated if it is longer than 7 m or wider than 2.55 m, and is not manufactured to BS 3632:2005 (see section 3).

(c) The sale of a caravan will be zero-rated if it is longer than 7 m or wider than 2.55 m, and is manufactured to BS 3632:2005.

Examples are given to illustrate types of supply. There are transitional rules for second-hand caravans which were zero-rated on an earlier sale to continue to enjoy the same treatment on subsequent sales.

Information Sheet 11/2012

2.5.2 Updated Notice

HMRC have issued an updated version of their notice *Fuel and power*. This explains when the lower rate of VAT may apply, as well as other matters connected with the supply of gas, electricity and other forms of power such as the Climate Change Levy.

Notice 701/19

2.5.3 Withdrawal of reduced rate

The government is asking for comments from businesses affected by the withdrawal of the reduced rate for the installation of energy saving materials in charitable buildings. The European Commission has also suggested that the rate should not be available for the installation of ESM in residential accommodation, but the government proposes to resist this.

HMRC would like the answers to the following questions by 20 October 2012:

1. Does the proposed date (1 August 2013) for the removal of the reduced rate for the installation of ESM in relevant charitable buildings present any particular problems? If so, can you explain what they are and what alternatives you propose?

2. Are there any particular factors that HMRC should take into account when making this change?

R & C Brief 26/12

2.5.4 Consultation on cable-based transport

HMRC have announced a consultation on the introduction of the 5% rate for small cable-based transport systems (e.g. ski lifts and the new Thames cable car crossing) which is planned to follow the 2013 Budget. Comments are requested by 17 October 2012.

The consultation document points out that:

- cable cars that carry not fewer than 10 passengers are already zero-rated;
- where such systems are situated in an amusement park for which an overall charge for admission is made, there will be a single standard-rated supply and it will not be possible to separate out a lower-rated element.

Draft legislation is included with the consultation.

www.hmrc.gov.uk/consultations/index.htm

2.6 Computational matters

Nothing to report.

2.7 Discounts, rebates and gifts

Nothing to report.

2.8 Compound and multiple

2.8.1 Land and services

A company provided a number of services to people wanting to play sport, in particular the management and administration of 5-a-side soccer leagues (in principle standard rated) and the hire of sporting facilities (potentially exempt if the conditions of Sch.9 Group 1 Item 1(m) and Note 16 were satisfied).

The exemption for hire of land does not include grant of facilities for playing sport unless the letting is for a continuous period of use exceeding 24 hours, or for 10 or more periods where the interval between such periods is not less than one day and not more than 14 days, and a number of other conditions are satisfied.

The Tribunal judge set out the principles which he had to consider in deciding whether there could be more than one liability attaching to the supply or supplies:

In considering whether the relevant activities of the Appellant constitute (i) multiple supplies, (ii) a single (composite) supply with one or more supplies being the principal service or services and the others being ancillary, (iii) a single (composite) supply which comprises a number of distinct elements which are indissociable and none of which is ancillary to the other even although some may predominate, or (iv) a single (composite) supply where it is necessary to preserve the independent character of each element of the supply, the authorities provide a number of factors or guidelines which should assist in identifying how a transaction or activity should be categorised.

The following, among other factors seem to be relevant to the facts and circumstances of the present appeal:-

i. The nature and extent of the transaction and the circumstances in which it takes place

ii. The essential features of the transaction

iii. What are its elements?

iv. Would it be artificial to split these elements; alternatively, would it be artificial to combine them?

v. Are they so closely linked that they form a single economic transaction which would be artificial to split?

vi. Is there a principal service consisting of one or more predominant elements?

vii. Is there an ancillary service consisting of one or more elements which does not constitute for consumers an aim in itself?

viii. Is the ancillary service a means of better enjoying the principal service?

ix. Are there various elements which fall to be treated as one over-arching supply?

x. Is one supply of no use without the other?

xi. Has a single price been charged?

The appellant was disputing an HMRC decision of 24 January 2011 that its supplies were effectively compound supplies of “participation in a football competition”, and that any land element was incidental to that. This view was published nationally in R&C Brief 04/11 in April 2011. The company asked for a review of the decision, which confirmed it:

HMRC does not think the supply falls within the land exemption because it is better described as a commercial activity/the provision of a service rather than merely the passive provision of space. HMRC think the supply comprises a bundle of elements, one of which may be land, but that the overarching supply is of participation in a sports league, and not one of land... the overarching supply is not one of a pitch. In HMRC’s view, but of participation in a league. What attracts teams to your business is the opportunity to participate in a league, not merely the opportunity to use a pitch.

Some teams booked the pitches alone. Single “casual” bookings were accepted by both sides as VATable; block bookings for 10 weeks were accepted by both sides as exempt. The dispute concerned those teams who decided to participate in leagues. The company argued that it ran leagues in order to promote pitch hire: encouraging regular participation meant that pitches would be utilised regularly.

Counsel for the taxpayer argued that HMRC had incorrectly characterised the company’s business as “the promotion of small-sided soccer games”, when it was in fact “the letting of facilities”. The purpose of the leagues was to maximise revenue from land. Separate contracts were entered into for the two elements, and terminating one (e.g. dropping out of a league) did not necessarily affect the other. For the customers, both services constituted independent and significant aims in themselves.

The Tribunal found it difficult to give a description of the supply that neatly defined it in terms of a single service. This was suggestive that there was no overarching single supply, but rather distinct elements. There also appeared to be separate contracts as a matter of fact, without over-zealous or artificial dissection.

The pricing structure did not support the argument that there was one principal element with an incidental minor element. The amount paid for league participation was relatively minimal. The fact that a global price was identified on the League Entry Agreement was relevant but not conclusive.

Overall, the Tribunal was satisfied that there were two supplies rather than a single complex one. It was therefore not necessary to consider what the overall nature of the supply was, because it would be artificial to combine the two into one. The separate elements should each have their own independent liabilities, which meant that the block bookings for at least 10 weeks would be exempt.

Counsel for the taxpayer argued that the principle of fiscal neutrality also supported exemption. However, the Tribunal was not persuaded that it was particularly relevant to the question of whether something was a multiple or a compound supply. In effect, the decision that something is compound or multiple determines the nature of the supply, and that determines whether two supplies are similar and should have the same VAT liability; to start with the proposition that they should have the same

VAT liability would prejudge the similarity between the supplies, which should be determined first on the facts, without reference to fiscal neutrality.

The chairman commented that HMRC's counsel had "skilfully elicited" the response from two "typical consumer" witnesses that they were buying a "package" from the company. This was also not particularly relevant – it did not determine whether there was a single or a multiple supply.

The appeal was allowed on the basis that there were separate taxable and exempt supplies. As a secondary conclusion, the Tribunal ruled that if there had been a single composite supply, it would have held that it was an exempt supply of land with incidental management services.

First Tier Tribunal (TC02253): *Goals Soccer Centres plc*

2.9 Agency

Nothing to report.

2.10 Second hand goods

Nothing to report.

2.11 Charities and clubs

2.11.1 Sale of donated animals

Another charity has succeeded in establishing its right to a *Fleming* claim (for £176,000) in respect of zero-rating sales of donated animals which had previously been regarded as outside the scope activities. It was VAT-registered in respect of a number of other sources of income.

In 1999 a visiting officer had discussed the treatment of "re-housing income" with the charity's officers, presumably considering that there was a possibility that it should be standard rated; the charity's accountants had written to HMRC in 2000, apparently without the agreement or authority of the charity, stating that:

". . . [Staff] are from time to time educated in how to deal with members of the public who enquire how much an animal will cost. Staff are trained not to quote a specific price but at the same time to encourage guardians to make a donation which is commensurate with the type of animal they are adopting."

Following the release of the Tribunal's decision VTD 20,519 *Gables Farm Dogs & Cats Home* in January 2008, the charity changed its view and began to treat the income as zero-rated. A claim for additional input

tax for periods from 2005 to 2008 was made and was accepted by HMRC; however, a *Fleming* claim was rejected. The reviewing officer commented that this was a unique "Dogs & Cats Home" claim, in that all the others were s.80 reclaims of output tax overpaid; this alone was a claim for input tax.

The case turned on whether the earlier treatment by the charity had been incorrect. The Tribunal accepted the charity's evidence that the "recommended donation" was always in reality consideration for a supply of the animal, and the accountants' representation in 2000 was both wrong and unauthorised. It also appeared that the reviewing officer had simply rejected the claim because it related to input tax and her internal guidance only referred to output tax claims – she did not appear to have considered the basis of the *Gables Farm* decision, because if she had, she would have inevitably had to allow the claim.

The appeal was allowed.

First Tier Tribunal (TC02118): *Wood Green Animal Shelters*

2.11.2 Charity guidance

HMRC have updated their detailed guidance notes for charities. Most of the guidance relates to non-VAT matters such as Gift Aid income tax relief claims, but there is an important section on recognition of charities for tax purposes which is relevant to claiming charitable VAT reliefs and exemptions.

http://www.hmrc.gov.uk/charities/tax/basics.htm

2.12 Other supply problems

2.12.1 TOGC?

A property development company treated the transfer of two buildings as VAT-free transfers of going concern. HMRC refused to accept this treatment and assessed for £447,300, initially on the basis that there was insufficient evidence that a letting business existed at the time of the transactions. By the time of the hearing, the appellant had produced more compelling evidence that agreements had been reached with tenants sufficient to constitute a business; but HMRC argued instead that the transactions could not qualify because they involved the grant of a sub-lease in the properties rather than the transfer of the whole of the supplier's interest. They were therefore the creation of new businesses rather than a transfer of what the supplier owned. Because of the change of approach, HMRC found themselves unable to raise an assessment for the whole of the VAT they thought was due – their original argument only applied to a third of the property, while the revised argument would have applied to the whole of it.

The Tribunal examined the background to all the transactions, which included transfers to companies connected with the appellant. It concluded that there was a business for VAT purposes at the time of the transfers. It also examined the headlease, which was granted to the

developer for a period of 125 years and which did not allow the developer to assign it. This was the reason for the creation of new sub-leases for a period of 3 days less than the headlease term.

The Tribunal concluded that the TOGC provisions are to be interpreted according to the substance of the transaction rather than its precise legal form. In that light, the retention of a small residual interest in the property was not relevant: the essence of the letting business had been transferred in the form of the economic rights over the property, and the part that was not transferred was only retained because of the requirements of the headlease.

The appeal was allowed.

First Tier Tribunal (TC02046): *Robinson Family Ltd*

2.12.2 Updated toolkit

HMRC have updated their VAT toolkits which are made available for agents to help their clients complete accurate returns. As before, the toolkits are detailed questionnaires which examine the reliability of the systems which produce the VAT return, rather than checking the underlying data. They are certainly useful as a training tool and a systems design aid, as they highlight risks which a good system should address; however, they appear to be too unwieldy for most businesses to pay their agents to complete them.

The output tax toolkit goes through the risk areas across a wide range of business activities, but still excludes specialist areas such as TOMS.

http://www.hmrc.gov.uk/agents/toolkits/VAT-output-tax.pdf

2.12.3 Sports leagues

The Daily Telegraph (12 July 2012) reports that sports leagues are concerned that they may have to start charging VAT, which may (according to the article) lead to the ending of free use of sporting facilities for schoolchildren. This appears to be a delayed reaction to the issue of R*&C Brief 04/11*, in which HMRC commented that sports leagues generally provide more than mere land (which would be exempt) and should therefore charge VAT on their income. The effect on children arises from the practice of allowing free daytime use of facilities by schools, effectively paid for by the commercial provision of the same facilities in the evening. Although the free use would presumably not create a VAT charge, the loss of revenue from paying output tax on the evening income would necessitate recovery somewhere else – hence the charge for the schools' use.

The writer of the article claims to have spoken to organisers of several sports leagues which have "never paid the tax". However, the majority of those commenting online on the article disagree with the factual basis and the suggestion that VAT should not be charged by commercial organisations on the provision of something that is clearly subject to the tax.

http://www.telegraph.co.uk/sport/football/VAT-5-side-football/9396445/VAT-on-five-a-side-football-will-end-many-free-sessions-for-children-as-leagues-threaten-to-cut-back.html#

3. LAND AND PROPERTY

3.1 Exemption

3.1.1 Compound or multiple?

A firm of solicitors leased premises which were not opted by the landlord. Following the *Tellmer* decision, the firm decided that the landlord's provision of services in relation to the premises constituted a taxable supply, so it submitted a claim for repayment of VAT. HMRC resisted this, arguing that the supply was compound and exempt, and no VAT invoice had been issued by the landlord.

The court commented that it is settled case law that every supply must normally be treated as distinct and independent and given its own VAT treatment accordingly. However, it is also possible that a transaction consisting of several elements should be regarded as a single supply. The judgment draws the fine distinction between *Levob* ("*two or more elements or acts supplied by the taxable person are so closely linked that they form, objectively, a single, indivisible economic supply, which it would be artificial to split*") and *CPP* ("*where one or more supplies constitute a principal supply and the other supply or supplies constitute one or more ancillary supplies which share the tax treatment of the principal supply. In particular, a supply must be regarded as ancillary to a principal supply if it does not constitute for customers an end in itself but a means of better enjoying the principal service supplied*").

It would be for the referring court to determine whether these principles applied to the facts of a particular case, but the CJEU gave some guidance on how that decision might be reached. These include the comments:

Obtaining the services concerned cannot be regarded as constituting an end in itself for an average tenant of premises such as those at issue in the main proceedings, but constitutes rather a means of better enjoying the principal supply, namely the leasing of commercial premises.

As to the relevance of the fact that a third party could in principle supply certain services, it must be observed that the existence of such a possibility is not decisive in itself either. As may be seen from the Court's case-law, the possibility that elements of a single supply may, in other circumstances, be supplied separately is inherent in the concept of a single composite transaction.

On that basis, it seems likely that HMRC will win when the case is remitted to the UK.

CJEU (Case C-392/11): *Field Fisher Waterhouse LLP v HMRC*

3.1.2 Wedding receptions

A company organised functions such as wedding receptions at a castle. The supplies included refreshments and might also extend to bed and breakfast overnight accommodation. It treated a large part of its supplies as exempt; HMRC assessed the company for VAT and interest of £296,000 plus a misdeclaration penalty of £23,000.

The company's contention was in essence that the facilities received by the customer were multiple supplies from multiple suppliers, and it

provided an exempt licence to occupy the premises. It charged VAT on certain elements of its supplies, including refreshments and bed and breakfast, horse and carriage hire, drinks from the bar and a share of the separate caterer's charge.

The Tribunal considered the precedents both on the interpretation of exemptions and the meaning of "letting of immovable property", and concluded that there was no licence to occupy land:

"*The arrangements do not confer on the client exclusive rights of possession, occupation or control or the right to exclude others. Rather, these arrangements constitute the active commercial exploitation of the Castle as part of an overall package of supplies. The nature of the arrangements does not have the flavour of the grant of a licence of land, but is best understood as the provision of a range of commercial services part of which is making the Castle and its grounds available for use. These services include the benefits of management, superintendence and maintenance of the Castle. The provision of the Castle and the selected additional services supplied by the Appellant and third parties all go hand in hand. This is not the relatively passive activity of letting of land as contemplated by Article 13 of the Sixth Directive.*"

Several UK Tribunal precedents which concerned wedding services were also considered. This case fell within the line of cases in which there was a composite supply of facilities rather than separate supplies of land and facilities. The appeal against the assessments was dismissed, and there was no reasonable excuse to counter the misdeclaration penalty.

First Tier Tribunal (TC02111): *Drumtochty Castle Ltd*

3.1.3 Similar to a hotel

A married couple ran a motel. Some studio flats were supplied on rental to a local authority for people who needed housing (e.g. homeless people or those seeking refuge from domestic violence). HMRC ruled that all the rental income was VATable; the couple appealed, arguing that the flats were rentals of residential accommodation and should be exempt. This was in accordance with advice that had been received from the National Advice Centre after a local authority had questioned the charging of VAT (transcripts of two telephone calls was produced as evidence of this).

The Tribunal had considerable sympathy with the appellants, who had clearly tried at all times to do the right thing. However, they had not asked the right questions of the Advice Centre; the accommodation they were letting was too similar to the rest of their motel operation, and the occupation was always of a temporary nature rather than "as a residence". If someone stayed for over four weeks, the rate of VAT should be reduced, but otherwise standard rated VAT applied. A number of precedent cases was considered which backed up this view.

First Tier Tribunal (TC02179): *Mr and Mrs C Ward*

3.1.4 Land or shares?

A Netherlands company was instructed by a Swedish business to find a buyer for a property in the Netherlands which it owned through a locally incorporated company. The Netherlands company was effectively acting as an estate agent, but the transaction that it arranged was the transfer of

shares. The company did not account for VAT on its fees, regarding it as either exempt financial services or else outside the scope as a financial service supplied to a business elsewhere in the EU. The Netherlands tax authorities assessed for VAT on the basis that it was a taxable transaction relating to land in the Netherlands. Questions were referred to the CJEU.

The Court ruled that the legal form of the transaction should be followed: the subject matter was shares, and arranging a transfer of shares was exempt. It was open to member states to disapply this exemption in the case of shares of companies which represented land (now art.15(c) Principal VAT Directive), but the Netherlands had not done so. Although this might appear to undermine fiscal neutrality, the clear wording of the law had to be followed.

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

3.1.5 New or old buildings

Supplies of buildings are generally exempt under the Principal VAT Directive, but member states may introduce an option to tax, and may also provide that “the supply, before first occupation, of a building or parts of a building and of the land on which the building stands” is taxable (art.12(1)). The Netherlands has incorporated that provision into its law.

A company purchased a shopping mall. The existing buildings were in process of demolition, and the purchaser intended to carry out construction of a new building. At the time of the supply, one of the existing shops was still in operation. The tax authority ruled that the transfer was exempt from VAT, which would mean a 6% property transfer tax applied. The purchaser claimed that art.12(1) applied and the supply was therefore VATable, which would have negated the transfer tax.

The Court considered the facts and the background and ruled that the property did not fit the description “building before first occupation”. It was therefore not covered by the Netherlands law implementing art.12(1), and it was exempt.

CJEU (Case C-326/11): *Komen en Zonen Beheer Heerhugowaard B.V. v Staatssecretaris van Financiën*

3.1.6 Borderline anomalies

In an article in *Taxation*, Neil Warren examines a number of the changes and concludes that the original stated intention of “simplification” is far from being achieved.

Taxation 6 September 2012

HMRC have issued a series of Information Sheets giving details of where the “borderline anomaly” amendments in the 2012 Budget have ended up. These include more details of the anti-forestalling provisions which apply to approved alterations to listed buildings (see section 3.3) and to the provision of self-storage facilities. The requirements for invoicing are covered, together with examples of the type of transaction which is caught by the rules.

Information Sheet 09/2012

Another Information Sheet explains the significance of the new rules on chair rental for hairdressers. Not surprisingly, it states that the rule change only confirms what was very likely to be the case already, and gives the very limited example of rental of an entire shop or floor as something which can remain exempt as a licence to occupy land.

Information Sheet 13/2012

The Information Sheet about the changes to the rules on self-storage facilities includes a large number of possible questions about the application of the rules, including the operation of the capital goods scheme, supplies straddling 1 October 2012, and the anti-avoidance provisions which in some cases will lead to a supply continuing to be regarded as exempt.

Information Sheet 14/2012

3.2 Option to tax

3.2.1 Option over partially residential property

Two companies in the same group owned chains of pubs over which they had exercised an option to tax. The appellants had for some years operated a 90:10 split in applying VAT to rent, regardless of the circumstances of any individual pub (some of which had no residential accommodation). This was in accordance with an industry-wide agreement between the Brewers' Society and HMRC dating from 1989.

In 2008, the companies questioned the split, and argued that the rent was derived only from the commercial areas – in effect, the residential areas "came free" with the pub. They proposed to charge VAT on the whole of the rent; this would affect their ability to recover VAT on their directly attributable property expenses, and also on their overheads. HMRC ruled that the rent had to be apportioned between the commercial premises and the residential areas, with VAT only applied to the commercial part.

The First Tier Tribunal agreed with HMRC, holding that the rental agreements could not be interpreted as charging rent just for the commercial parts and providing the rest free. The companies appealed to the Upper Tribunal.

The judge considered precedents on the link between consideration and supply. He did not accept HMRC's argument that the rent had to be treated as for the residential as well as the commercial parts simply because the contracts did not draw any distinction. He commented that the 90:10 split implied that the rent was not equally attributable to every square foot of the premises: the apportionment had not been considered by the FTT because it had been common ground that the agreed split was appropriate if the appellants lost.

However, he also rejected the appellants' counsel's arguments against the FTT's decision. It would be necessary to show that the FTT had erred in law, or had reached a decision which was unreasonable on the basis of the evidence; the judge considered each of the criticisms levelled by counsel and concluded that the decision could not be so undermined. The FTT

was entitled to arrive at the conclusion that some of the rent was attributable to the residential areas, so the appeal was dismissed.

Upper Tribunal: *Enterprise Inns plc and another v HMRC*

The judge stated that "*Had the agreements between the Appellants and the tenants, on their true construction, attributed some of the rent to the residential areas, that might well have been determinative of itself.*" However, it is not clear whether the reverse would have held – that a contract specifying that the rent was only for the commercial parts would have determined the issue in favour of the appellants.

Presumably a contract which provided that the whole of the rent related to the commercial premises, if upheld as realistic, would not adversely impact the tenants – the whole of the expense would be incurred in relation to the business, not the private accommodation, so the whole of the VAT charged would be recoverable (as the pub would almost certainly be fully taxable).

3.3 Developers and builders

3.3.1 Approved alterations

HMRC have published an Information Sheet to give more details of the change to the rules on the zero-rating of approved alterations to listed buildings, and in particular the conditions for the transitional relief for projects which were effectively in progress on Budget day.

The conditions for the transitional relief, which applies to supplies made up to 30 September 2015, are as follows:

Approved alterations – the transitional rules apply to works which are within the scope of:

- *A 'relevant consent' applied for before 21 March 2012; or*
- *A written contract entered into before 21 March 2012.*

First grant of a major interest in a substantially reconstructed protected building – the transitional rules apply to the first grant of a major interest in a substantially reconstructed protected building where 3/5ths of the work (by cost) relates to approved alterations:

- *If those approved alterations are within the scope of a 'relevant consent' applied for before 21 March 2012 or of a written contracts entered into before 21 March 2012; or*
- *If 10 per cent of the substantial reconstruction (measured by cost) was completed prior to 21 March 2012.*

There are detailed descriptions of the terms used and situations in which the relief may be in question, for example where an existing contract is varied after 21 March 2012.

Information Sheet 10/2012

3.4 Input tax claims on land

3.4.1 Planning consent considered

An individual purchased some agricultural buildings and carried out a project to convert them into a house and an office. Initially he made a DIY claim in relation to the whole cost, but by the time of the hearing he had accepted that no claim could be made in relation to the costs of the office. HMRC refused the claim on the house because the vendor of the land had entered into an agreement with the local authority under s.106 Town and Country Planning Act 1990. This prohibited the separate disposal of the barn and office which were the subject of the DIY project.

The Tribunal accepted the appellant's argument that elements of the s.106 agreement were only binding on the person who had entered into it, not on a successor in title to the land. Although the appellant could only use the office in accordance with the terms of the s.106 agreement, it did not prevent his separate use of the house, and as a result did not invalidate a DIY claim. The chairman summed up by saying, "*The relevant point is that the barn can be sold or otherwise disposed of as what it is, a dwelling with office premises adjacent. It seems that the fact that the Appellant originally included a VAT refund claim in respect of the conversion of the office took the whole matter off on a tangent.*"

The appeal was allowed.

First Tier Tribunal (TC02180): *Mr Simon Jones*

3.5 Other land problems

3.5.1 Listed places of worship

The Department for Culture, Media and Sport (DCMS) has announced details of the extension of the Listed Places of Worship grant scheme following the Budget withdrawal of zero-rating for approved alterations to listed buildings from 1 October 2012 (subject to transitional rules). An extra £30m has been allocated to fund the cost of VAT in repairs to listed places of worship.

Because of the nature of the change to the VAT rules, some restrictions on what can be claimed have been removed. A new application form and a detailed guidance document will be available on the LPW website (www.lpwscheme.org.uk/index.htm) in late September 2012. The existing rules and criteria for the scheme will remain in place until 1 October 2012.

Department for Culture, Media and Sport Release 14 August 2012

4. INTERNATIONAL SUPPLIES

4.1 E-commerce

4.1.1 Rates

HMRC have published the usual schedule of exchange rates to be used by those registered under the special scheme for e-traders in the quarter to June 2012.

Information Sheet 05/2012

Also for the benefit of e-traders, HMRC have announced that the standard rate of VAT in Latvia decreased from 22% to 21% on 1 July 2012...

Information Sheet 06/2012

...and that the standard rate in Spain increased from 18% to 21% on 1 September 2012.

Information Sheet 08/2012

4.2 Where is a supply of services?

4.2.1 Supplies connected with land

HMRC have announced a change of policy in relation to the place of certain types of land-related supply. This is a result of "discussions at EU level". The change only relates to place of supply, and does not affect any views on the correct rate to apply if the supply is in the UK.

HMRC give the following clarification of what is meant by a "supply of land" and "services related to land":

For the purpose of determining the place of supply, land means any:

- *specific part of the earth, on, above or below its surface, over which title or possession can be created*
- *building or construction fixed to or in the ground above or below sea level which cannot be easily dismantled or moved*
- *item making up part of a building or construction and without which it is incomplete (such as doors, windows, roofs, staircases and lifts)*
- *item, equipment or machine permanently installed in a building or construction which cannot be moved without destroying or altering the building or construction.*

In order for a service to be land related for determining the place of supply it must have a sufficiently direct connection with a specific piece of land.

This will include services:

- *derived from land and where the land is a central and essential part of the service*
- *intended to legally or physically alter a property.*

Examples of services relating to land which are subject to VAT where the property is situated

- *Construction or demolition of a building or permanent structure (such as pipelines for gas, water or sewage).*
- *Surveying and assessing property.*
- *Valuing property, including for insurance or loan purposes.*
- *Providing accommodation in hotels, holiday camps, camping sites or timeshare accommodation.*
- *Maintenance, renovation and repair of a building (including work such as cleaning and decorating) or permanent structure.*
- *Property management services (but not the management of a property investment portfolio).*
- *Arranging the sale or lease of land or property.*
- *Drawing up of plans for a building or part of a building designated for a particular site.*
- *On-site security services.*
- *Agricultural work on land (including tillage, sowing, watering and fertilization).*
- *Installation and assembly of machines which, when installed, will form a fixture that cannot be easily dismantled or moved.*
- *The granting of rights to use all or part of a property (such as fishing or hunting rights and access to airport lounges).*
- *Legal services such as conveyancing and drawing up of contracts of sale or leases.*
- *Bridge or tunnel toll fees.*
- *The supply of space for the use of advertising bill-boards – for example the leasing of a plot of land or the side of a building to allow a billboard to be erected.*
- *The supply of plant and equipment together with an operator, to allow the customer to carry out work on land or property where the supplier has responsibility for the execution of work.*

Examples of services not relating to land

- *Drawing up of plans for a building or part of a building that do not relate to a particular site.*
- *Arranging the supply of hotel accommodation or similar services.*
- *Installation, assembly, repair or maintenance of machines or equipment which are not, and do not become, part of the land or property.*
- *Management of a property investment portfolio.*
- *Advertising services that involve the use of a billboard.*

- *The supply of equipment with an operator, where it can be shown that the supplier has no responsibility for the performance of the work.*

HMRC consider that the change of policy will impact on three specific types of supply:

- stand space at exhibitions and conferences, which has been regarded as a supply of land. This policy will continue where the service is restricted to the mere supply of space without any accompanying services. However, where other services are provided as part of a package, this will in future be regarded as a single supply which is not a supply of or related to land, and it will be taxed where a business customer belongs.
- storage of goods, which has been regarded by HMRC as land-related in all cases. In future, it will only be regarded as land-related if there is a supply of a specific identifiable part of a UK warehouse for the exclusive use of a customer to store goods. The provision of storage facilities will be treated as a general service.
- access to airport lounges, which has not been regarded as a land-related supply. In future, HMRC will treat it as land-related, so it will be taxed in the country in which the lounge is situated.

Businesses may adopt the new policy immediately, or may continue to use their existing treatment for a transitional period of three months. Traders can claim a refund in relation to past periods, but HMRC will consider whether the defence of unjust enrichment applies: claimants will need to show that the customer has not recovered the VAT charged, and that any VAT recovered will be handed on to the customer.

Revenue & Customs Brief 22/2012

4.3 International supplies of goods

4.3.1 To Germany and back

A soldier who was serving in Germany bought a car in the UK and claimed a refund of the VAT under the New Means of Transport rules (SI 1995/2518 reg.155). Under the special rules for NATO forces stationed in member states, he was not liable for German VAT on the car's arrival there.

The soldier took the car to Germany for only 2 days, but was then sent back to the UK for training before temporary deployment in Africa. When this ended after 6 months, he returned to the UK, where the car had been left in the meantime. As he was no longer on foreign assignment, HMRC sent a letter to recover the VAT he had reclaimed. He argued that his circumstances at the time of the claim entitled him to the refund, and there was nothing in the law to permit HMRC to claw it back again.

The chairman noted that HMRC were unable to refer to any statutory or regulatory basis for their request for the money, which did not use any of

the usual language of "assessment". He concluded that there was no legal basis for imposing a liability on the purchaser in these circumstances.

He also considered that the evidence supported a genuine intention at the time of purchase to remove the car to Germany; the change in circumstances which led to the soldier returning to the UK with the car were unknown at the time and were therefore irrelevant, even though they came about shortly afterwards. The appeal was allowed.

It is possible that the German authorities will pursue the soldier for the German VAT on the basis that it did not satisfy the conditions for the exemption for NATO stationed staff; however, the Tribunal chairman (while not having jurisdiction in Germany) pointed out that the UK Army's 2009 standing orders concerning such vehicles were unclear about the conditions, and the version that HMRC produced at the hearing had been changed.

First Tier Tribunal (TC02072): *A Soldier*

4.3.2 Postal import values

In a "paper appeal" (Tribunal Procedure Rule 29), an individual protested about the amount of VAT imposed by the Border Agency on two parcels he received in the mail from Canada. The values were stated in Canadian dollars, and VAT was charged on the values including postal charges, converted into sterling.

Although the EC Regulations normally impose import VAT on the value including carriage charges, this does not apply to consignments of a non-commercial nature. The appeal was allowed to that extent.

On the other ground, the appellant had provided no evidence to support his assertion that the correct exchange rate should be the "tourist rate" of $1.55 = £1. Similarly, the respondents had not produced any evidence to support their rate of $1.528 = £1. As it was for the appellant to displace the assessment, the appeal in respect of this point was dismissed.

First Tier Tribunal (TC02075): *EW Dobson v UK Border Agency*

4.3.3 False import declaration

TNT acts as a freight agent for some customers. In this capacity it made import declarations in respect of computer components which were imported from the USA into the UK via the Netherlands. The customer gave TNT a "borrowed" VAT number, and claimed that the conditions for inward processing relief were met. When no discharge certificates were applied for, HMRC approached the company whose VAT number had been used; when it transpired that it had nothing to do with the transactions, HMRC issued a post-clearance demand on TNT for £265,000. The customer and the goods had disappeared, presumably into free circulation in the UK.

It was accepted that TNT was the innocent victim of a deception. However, it had taken responsibility for the declarations, and was therefore bound by them as if it was acting on its own behalf. The appeal was dismissed by both the First Tier and Upper Tribunals.

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

4.3.4 Intra-community supply rules

The full court has now given its ruling in the case about intra-community supplies of goods where the customer is not established in the EU and is not registered for VAT in the EU. The circumstances were similar to a triangulation transaction, except that the intermediate supplier was American: a German company sold equipment to a US customer and delivered them directly to the US company's final customer in Finland. The German authorities ruled that the German company had to charge VAT.

The Advocate-General's opinion was not available in English, but it appeared to suggest that member states should not restrict exemption (i.e. zero-rating) of intra-community despatches by imposing a requirement that the supplier has recorded the customer's VAT registration number. This would be a surprising conclusion, because it is normally regarded as a condition for treatment as a despatch. It would also remove one of the conditions for triangulation to apply – that all three parties are registered for VAT in different member states.

The full court has effectively confirmed the opinion, but with a proviso. Member states are permitted to require the customer's registration number in order for a despatch to be exempted; however, if a supplier, acting in good faith and after taking all measures that can reasonably be expected, is unable to provide the VRN but can produce other evidence which demonstrates that the recipient of the supply is a taxable person acting as such, the member state of despatch should not refuse to exempt the transaction only because the VRN is missing.

The requirements of the law are that the acquirer must be a taxable person, the goods must be supplied in that the right to dispose of them passes, and they must physically move from one country to another. The production of a VRN is a good way of satisfying the first condition, but to make it the only way would be disproportional.

CJEU (Case C-587/10): *Vogtländische Straßen-Tief und Rohrleitungsbau GmbH (VSTR) v Finanzamt Plauen; other participant: Bundesministerium der Finanzen*

4.3.5 Updated Notices

HMRC have issued an updated version of their Notice on *Imports*. The main change since April 2010 relates to the valuation method for antiques and works of art (section 3.4). The valuation method achieves an effective rate of 5% on such items by applying a fraction to what would otherwise be the value, then charging the standard rate of VAT; the fraction is updated for the change from 17.5% to 20%.

Notice 702

HMRC have also published an "Easy Read" version of Notice 704/1 *Tax free shopping in the UK*. This is aimed at helping overseas visitors obtain a VAT refund on goods they buy while in the UK. It includes helpful definitions of words used and contact details for more information.

Notice 704/1 Easy Read

4.4 European rules

4.4.1 Fraud response mechanism

The Commission has issued a draft Directive proposing a "Quick Response Mechanism" to combat emerging threats of VAT fraud. This would permit member states which identify a "massive and sudden" risk of fraud to impose a reverse charge mechanism under a temporary derogation. This could be done within a month and last for up to a year.

The taxation commissioner commented that "When it comes to VAT fraud, time is money." Speeding up the process for implementing countermeasures would enable member states to stem the huge losses of the past, which have been estimated at €5bn in relation to emissions allowances between June 2008 and December 2009, and up to £29bn in relation to mobile phones and CPUs over the last decade.

IP/12/868

Meanwhile, the Commission has reported on the perceived effectiveness of the measures introduced in art.263(1a to 1c) – the extension of "recapitulative statements" (EC Sales Lists) to services and the shortening of the time limits for submission that were introduced with the VAT package on 1 January 2010.

The conclusion of the report is that "it is too early to say", but the study concludes that the quality of information has improved without creating a disproportionate burden on business.

http://ec.europa.eu/taxation_customs/resources/documents/common/publications/com_reports/taxation/com(2012)337_en.pdf

4.4.2 Commission discussions

The Commission has published the responses to its consultation on double taxation and non-taxation.

http://ec.europa.eu/taxation_customs/common/consultations/tax/2012_double_non_taxation_en.htm

The Commission has also decided to set up an "EU VAT Forum". This is supposed to bring together business people and tax officials to combine their experience in the interests of improving the VAT system and reduce administrative burdens.

Commission Decision 3 July 2012: 2012/C 198/05

The appointed members of what now seems to be called the "VAT Expert Group" were announced in September. Their stated tasks are:

- to advise the Commission on the preparation of legislative acts and other policy initiatives in the field of VAT;
- to provide insight concerning the practical implementation of legislative acts and other EU policy initiatives in the field of VAT.

http://ec.europa.eu/taxation_customs/taxation/vat/key_documents/expert_group/index_en.htm

4.4.3 Effectiveness of rights

A Bulgarian company bought a number of second-hand commercial vehicles from a Spanish company in November 2008. It subsequently registered for VAT in Bulgaria and completed the paperwork in relation to the intra-Community acquisition in June 2009. The Bulgarian authorities disallowed the deduction of input tax on the grounds that it was not exercised in the correct period, and levied default interest on the delayed accounting for acquisition tax. The Bulgarian law requires traders to exercise the right to deduct in the period in which it arose or in one of the next three tax periods (of one month each), and this trader had missed the deadline. Bulgarian law has subsequently been amended to extend the deadline to 12 periods, and also to provide that liability for and recovery of VAT accounted for under a reverse charge procedure are automatically to be offset without regard to the time limits.

The court gave a ruling which was consistent with the *Marks & Spencer* decision:

- a time limit for the exercise of rights was acceptable under the Directive, as long as it did not effectively deprive the taxpayer of any opportunity to benefit from those rights;
- the denial of deduction of input tax was not acceptable as a "penalty" for failing to meet the deadline, but default interest was acceptable, as long as it was "proportional".

In both cases, it would be for the national court to determine whether the principles of effectiveness and proportionality were satisfied in the particular circumstances. The subsequent considerable extension of the legal limitation period should be taken into account by the national court in determining whether the three-month period was unreasonably short.

The court observed that it was not possible to deny input tax deduction merely on the grounds that a taxpayer was not registered, if the substantive conditions for deduction were clearly met. A denial of deduction appeared to be disproportionate where there was no apparent intention to defraud or loss to the public revenue.

CJEU (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*

4.4.4 Alterations to capital item

A married couple were VAT-registered as a partnership. They purchased a warehouse for the purposes of the business; part of the attic was temporarily used as their residence, and a number of adaptations were carried out in order to make it suitable for occupation. The partnership claimed input tax in relation to the costs of these alterations. The Netherlands authorities disallowed the tax, and questions were referred to the CJEU.

The Advocate-General considered the situation in detail and examined a number of possible outcomes. Her conclusion was that the dwelling could be regarded as a separate capital item within the warehouse, and it was not necessary for it to be treated in the same way as the warehouse itself – it would be possible for it to be treated as 100% private, even if it was

acknowledged that the warehouse was mixed or wholly business use. However, it would also be possible to find that the intention to use the alterations for business purposes later (when the rooms would be used for offices or training facilities) could justify deduction at the time the expenditure was incurred, even if the use was 100% private at that time.

It would be for the national court to determine whether the expenditure constituted a separate capital item, and also to determine whether there was objective evidence of an intention for business use after the private use.

The full court considered the principles which must be applied to determine whether a taxable person is "acting as such" in making any purchase. This should be based on objective evidence, and if that objective evidence suggests that the taxable person acquired goods solely for private purposes, there would be no right of deduction.

The objective evidence included the use to which the goods were actually put, the nature of the goods themselves (i.e. whether suitable for mixed business and private use), and the fact that they formed part of an asset which was undoubtedly used for business.

The court concluded that the right to deduct existed where a taxpayer purchased something which would be used for business after temporary private use; it was not relevant whether input tax been charged and deducted on the acquisition of the capital item to which the alterations were made.

CJEU (Case C-334/10): X*; other party v Staatssecretaris van Financiën*

4.4.5 Airlines

A Finnish company (A) purchased two aircraft from a French manufacturer. The aircraft were operated by a connected company (B) in Finland, which provided them mainly for use by the principal shareholder. Later both aircraft were sold to another company which was registered in Cyprus. At this point the Finnish authorities became aware of the transactions and demanded acquisition tax on the arrival of the aircraft from France. The company appealed, arguing that it was entitled to have been registered for VAT in respect of supplies to B, and that those supplies were exempt under EU law because they were made to "an airline operating for reward chiefly on international routes".

The Finnish court referred questions to the CJEU on the interpretation of these provisions. The Court ruled that these arrangements satisfied the conditions for exemption:

(1) The wording 'operating for reward on international routes' in art.15(6) 6th Directive should be interpreted as encompassing also international charter flights to meet demand from undertakings and private persons such as X.

(2) The exemption in art.15(6) extended to the supply of an aircraft to an operator (A) who was not itself an 'airline operating for reward chiefly on international routes' but which acquired that aircraft for the purposes of exclusive use thereof by such an undertaking (B).

(3) The circumstances of the case, namely the fact that the purchaser of the aircraft (A) passed on the charge corresponding to its use to an individual (X) who was its shareholder and who had used that aircraft essentially for his own business and/or private purposes, with the airline (B) also having the opportunity to use it for other flights, did not invalidate the application of the exemption.

CJEU (Case C-33/11): *A Oy*

4.4.6 Anti-fraud measures

A Hungarian company sold agricultural produce to a purchaser which claimed it was in business in Italy and would transport the goods to Italy. The transaction was therefore treated as an exempt despatch. However, later enquiries revealed that the address of the supposed business was false, and the registration number had been cancelled by the Italian authorities with retrospective effect. The Hungarian authorities imposed liability and a tax penalty on the supplier, which appealed. Questions were referred to the CJEU on the application of the intra-community exemption. In particular, the court was asked whether an absolute liability arose if the goods could not be shown to have left the supplier's member state.

The court ruled that the precedents of *Teleos* and *Euro Tyre Holding* showed that such absolute liability did not apply: imposing such a condition went beyond what was necessary to ensure the straightforward application of the exemption. However, a member state could consider the good faith of a supplier in applying the exemption: if the trader had not done everything that could reasonably be expected to satisfy itself of the genuine nature of a transaction, it was permissible to deny exemption. The CJEU notes that the basis of the appellant's claim was that it had been given an Italian VAT number by the purchaser, foreign-registered vehicles had collected the goods, and the customer had returned transport documents by post "confirming" that the goods had arrived in Italy. It would be for the referring court to determine whether this was enough to satisfy the good faith requirement.

On the other hand, it was not permissible to deny exemption solely on the grounds that another member state's tax authority had retrospectively cancelled the VAT registration of the customer.

CJEU (Case C-273/11): *Mecsek-Gabona Kft v Nemzeti Adó- és Vámhivatal Dél-dunántúli Regionális Adó Főigazgatósága*

A building contractor paid sub-contractors to do certain works, and claimed input tax purportedly charged on the sub-contractors' invoices. In respect of one such sub-contractor the tax authority disallowed the deduction on the basis that the supplier had had its licence to operate cancelled by the municipal authority; it appeared that the sub-contractor's workers were not recorded and the sub-contractor was therefore involved in tax fraud. The main contractor appealed, arguing that this should not prevent him from deducting VAT paid in good faith to a supplier.

The court ruled that the cancellation of an operator's licence on its own was not relevant to the entitlement to tax deduction. If the invoice complied with art.226 Principal VAT Directive, allowing the identification of the person who issued it and the nature of the services, it was prima facie evidence of entitlement to deduction.

The judgment continues in line with similar rulings on missing trader fraud: the income tax irregularities can only be a valid reason to deny a VAT deduction if there is objective evidence to suggest that the claimant knew or had the means of knowing that the transactions were connected with fraud; and the fact that the workers were tax "ghosts" was not on its own such objective evidence, if the claimant had no reason to suspect any irregularities.

CJEU (Case C-324/11): *Gábor Tóth v Nemzeti Adó- és Vámhivatal Észak-magyarországi Regionális Adó Foigazgatósága, as successor to Adó- és Pénzügyi Ellenorzési Hivatal Hatósági Foosztály Észak-magyarországi Kihelyezett Hatósági Osztály*

4.4.7 Second-hand scheme

Polish law allows partial VAT recovery by traders in respect of some cars. This is not in accordance with the Directive, but is covered by a "standstill clause" as a measure in force when Poland joined the EU. Where a trader has partially recovered the VAT, a partial VAT charge will be levied on the sale of the vehicle.

A second-hand car dealer included in the margin scheme both cars which were bought from people who charged no VAT and from people who made this partial charge following partial recovery. The Advocate-General gave an opinion that this is not in accordance with the Directive: the margin scheme can only apply to goods on which no VAT at all was charged, because no VAT has been recovered by the previous owner. Allowing other such goods to be included in the margin scheme would permit non-taxation of some of the proceeds of sale.

The full court has agreed with the opinion (and with the Polish authorities). There was an element of double taxation in requiring output tax on the full price charged by the second-hand car dealer, because the original owner's irrecoverable VAT (usually 40% of the input tax) would be built into the VATable cost; however, that was not a reason to depart from the clear wording of the Directive. The problem arose from the existence of the Polish standstill clause, and the solution was for the Polish law to be brought into line with the Directive.

CJEU (Case C-160/11): *Bawaria Motors sp ZOO v Minister Finansow*

4.4.8 In the tank

There is an exemption from import duty and VAT on fuel in the tanks of road vehicles which cross the EU border, making it unnecessary to declare or pay tax on whatever happens to be on board at the time. The Lithuanian authorities ruled in the case of a taxpayer that this also applied to diesel in the tanks of railway locomotives which crossed from Russia into Lithuania. The Commission disagreed, and applied to the CJEU for a ruling that trains were not covered by the exemption for road vehicles.

The court agreed with the Commission. There was settled case law to show that different modes of transport were not necessarily to be treated as interchangeable, so the principles of fiscal neutrality and equal treatment did not apply. The exemptions for road fuel did not extend to the tanks of locomotives.

CJEU (Case C-250/11): *Lietuvosg gelezinkeliai AB v Vilniaus teritorine muitine*

4.4.9 Holding company expenses

A Portuguese holding company incurred input tax on services which it supplied on to members of its group. It recharged the supplies at cost to the subsidiaries concerned, and deducted in full the input tax from the output tax due. The tax authority formed the view that it should only have deducted a proportion of the input tax, and issued an assessment. Questions were referred to the CJEU.

The court ruled that there would be a right of full deduction if the inputs had a direct and immediate link with outputs which carried a right of deduction (which appears to be the case if the purchases are recharged to subsidiaries). However, it would be for the national court to determine whether there is any other use of the inputs, for example for non-economic activities such as the mere holding of subsidiaries. If that was the case, the rules of partial exemption would not be relevant, but there would be an apportionment to disallow non-business VAT.

CJEU (Case C-496/11): *Portugal Telecom SGPS SA v Fazenda Publica*

4.4.10 Reverse charges

Under Council Decision 2004/290, Germany was allowed to derogate from the normal rules in art.21 6th Directive by imposing VAT liability on the purchaser of certain goods and services as set out in article 2 of that decision. These included "*where building-cleaning services are supplied to a taxable person, except where the recipient of the supply exclusively rents not more than two residences or where construction work is supplied to a taxable person*".

The German law was amended to impose a reverse charge on the purchaser of "*Supplies of pieces of work and supplies of services for the construction, repair, maintenance, alteration or demolition of structures, with the exception of planning and supervisory services... if he is a trader who makes supplies within the meaning of subparagraph 1...*"

The appellant company, a property developer, paid VAT to the authorities in respect of some purchase invoices issued by a contractor which had built a block of six flats on land the appellant company owned. The invoices had indicated that the customer was liable for the tax; the contract for the work specified a fixed price, so presumably the appeal would have imposed a liability on the contractor which would have come out of its profit.

Questions were referred to the CJEU about the interpretation of Council Decision 2004/290 and the level of flexibility afforded to Germany in applying its derogation. In particular, the German court asked whether the expression "construction work" included supplies of goods as well as

services, and if it did not, whether the derogation from art.21 extended in any case to supplies of goods.

The German authorities argued that the effect of an adverse ruling – that they had applied the law incorrectly – on their budget would be severe. Presumably they are concerned that a large number of companies will make very substantial claims for repayment. The Advocate-General's opinion is that this will not happen, and it is only in very exceptional cases that such an argument can be taken into account in determining how EU law should be applied.

The opinion favours the appellant: "construction work" encompasses only supplies of services; and national law cannot categorise something as "services" if, on general principles, it ought to be regarded as goods.

CJEU (A-G) (Case C-395/11): *BLV Wohn- und Gewerbebau GmbH v Finanzamt Lüdenscheid*

4.4.11 Self-supply of building work

A local council owned sports pitches which it let exempt to sports clubs. It paid a contractor to resurface the pitches, then continued to let them. The tax authority assessed for a self-supply charge on the value of the resurfaced pitches, including the land, and allowed a deduction for the VAT charged by the contractor. The council appealed, arguing:

- that a self-supply charge could not apply where the work was carried out by an outside contractor who charged VAT;
- that it was wrong to include the value of the land, where the council had already used the land in exempt letting and had therefore never enjoyed any deduction of input tax in relation to that land.

The case concerns the extent to which member states are allowed to impose self-supply charges by art.5(7)(a) 6th Directive. The Advocate-General has given an opinion that member states are only allowed to impose this charge where work is carried out on land that has not previously been used in the taxpayer's business; there is a risk of double taxation and distortion of competition if the provision is applied to land already in use. Accordingly, she agrees with the council that no such charge should be imposed in this case (although accepting that it is for the national court to determine whether the refurbished pitches can be regarded as something "new").

The A-G does not think it is relevant that the work was carried out by an outside contractor. That means that a self-supply charge might not be applied only to work carried out VAT-free by employees, but also to VATable construction work done on VAT-exempt land to create a new building.

CJEU (A-G) (Case C-299/11): *Staatssecretaris van Financiën v Gemeente Vlaardingen*

4.4.12 Subsidies and input tax

The Hungarian court has referred questions to the CJEU about the lawfulness of a State subsidy to compensation a trader where there is no right to deduct input tax. The questions are:

Can the fact that a taxpayer – where there is a prohibition on deduction – has obtained aid in such a manner that this also funds VAT or has obtained additional State aid as compensation for non-deductible VAT be categorised as the passing on of tax according to Community law?

If the answer is in the affirmative, would the answer be the same if the taxpayer did not receive the aid from a Member State or from the tax authority of a Member State, but instead the aid was paid – pursuant to the contract concluded with the person granting the aid – from European Union aid and the Member State's central budget?

Can the principles of repayment based on fiscal neutrality and of effectiveness, equivalence and equal treatment be regarded as satisfied, and the prohibition on unjust enrichment complied with, where – owing to legislation on the right to deduct that is contrary to European Union law – the tax authority of a Member State only upholds the taxpayer's claim for repayment or damages in relation to that part or proportion not previously funded through the aid referred to in the first two questions?

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

4.4.13 Adjustment of taxable amount

The Romanian court has referred questions about a situation in which a trader has been retrospectively classified as a taxable person and has therefore become liable for output tax which was not allowed for when the consideration was agreed between the parties to a transaction.

If a vendor has been reclassified as a taxable person for VAT purposes and the consideration for (price of) the supply of the immovable property has been determined by the parties, without any reference to VAT, must Articles 73 and 78 of Council Directive 2006/112/EC be interpreted as meaning that the taxable amount is:

a) the consideration for (price of) the supply of the property determined by the parties, less the rate of VAT, or

b) the consideration for (price of) the supply of the property agreed by the parties?

The answer in the UK would be clear: the price agreed between the parties would be treated as inclusive of any VAT that ought to have been charged, whether or not it was explicitly mentioned or considered at the time. The taxable amount will only be the net price paid if the contract provides that VAT will be paid in addition to this figure, or if the trader subsequently agrees with the customer that VAT can be charged retrospectively.

CJEU (Reference) (Case C-249/12): *Corina-Hrisi Tulică v Agenţia Naţională de Administrare Fiscală – Direcţia Generală de Soluţionare a Contestaţiilor*

4.4.14 High seas

French law provides for an exemption for shipping in relation to transport of passengers and commercial operations without the Directive's condition that the ships are used for navigation on the high seas. When the Commission sent a reasoned opinion to the French government, the law was changed, but an explanatory ministerial ruling effectively told taxpayers that there would be no change to the administrative practice. The Commission has now issued proceedings in the CJEU for a declaration that this is unacceptable.

CJEU (Application) (Case C-197/12): *European Commission v French Republic*

4.4.15 Lower rate

Digitally downloaded books are subject to lower rates of VAT in France (7%) and Luxembourg (3%). The Commission has commenced infringement proceedings against both countries, observing that electronic services are not on the list of goods and services to which a lower rate can be applied. The first stage is the issue of an enquiry, giving the states a month to respond. If the answers are not satisfactory, a reasoned opinion requesting a change of legislation comes next, then an application to the CJEU.

http://europa.eu/rapid/pressReleasesAction.do?reference=IP/12/740&format=HTML&aged=0&language=en&guiLanguage=en

4.4.16 Tax point rules

The Polish court has referred questions on the extent to which a member state can make its own rules to vary the tax point for a supply. The questions are:

Are the provisions of Article 66(a), (b) and (c) of [the Principal VAT Directive] to be interpreted as meaning that where a taxable person issues an invoice documenting the supply of a service covered by the power conferred on Member States by that article (derogation from Articles 63, 64 and 65 of Directive 2006/112), it is possible to determine the chargeability of the tax (liability to pay the tax) on the basis of Article 66(b) of Directive 2006/112 as arising on the date of payment, but no later than 30 days from the date on which the service is supplied?

Are the provisions of Article 66(a) and (b) of Directive 2006/112 to be interpreted as precluding the Polish national provisions in Article 19(13)(2)(a) and (b) of the Ustawa o podatku od towarów i usług (Law on the tax on goods and services) of 11 March 2004 (Dziennik Ustaw No 54, item 535, as amended) under which the time when the liability to pay the tax arises (the event on whose occurrence the tax becomes chargeable in respect of certain transactions) occurs in respect of transport and shipping services on receipt of payment in full or in part, but no later than 30 days from the date on which those services are supplied, even where an invoice laying down a later deadline for payment is issued and presented to the purchaser no later than seven days after the service is supplied and the purchaser of the service has the right to deduct input tax during the period in which he received the invoice, irrespective of whether or not he has paid for the service?

It appears that the national law compares to the UK law as follows:

- basic tax point – time of provision of services;
- issue of tax invoice after basic tax point – issue does not fix the tax point, but due date for payment specified on that invoice may vary the tax point as long as the invoice is issued within 7 days of the basic tax point;
- receipt of money within up to 30 days after basic tax point – fixes the charge at that time;
- if no invoice is issued within 7 days of the basic tax point, the basic tax point is the chargeable event.

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

4.4.17 One stop shop on the way

The Commission has published an implementing regulation which sets out the framework for member states' systems to administer the new reverse charge mechanisms for telecommunications, broadcasting and electronic services that will come into force on 1 January 2015.

Implementing Regulation 815/2012 13 September 2012

4.5 Reclaiming foreign VAT

4.5.1 Tax representatives and the 8th Directive

The Romanian court has referred the following questions to the CJEU:

May a taxable person having its principal place of business in a Member State of the European Union other than Romania, and that has identified for VAT purposes a tax representative in Romania, on the basis of the provisions of domestic law in force before Romania acceded to the European Union, be regarded as a 'taxable person not established in the territory of the country', within the meaning of Article 1 of Eighth Council Directive 79/1072/EEC of 6 December 1979 on the harmonisation of the laws of the Member States relating to turnover taxes – Arrangements for the refund of value added tax to taxable persons not established in the territory of the country?

Does the requirement, laid down in Article 1472(1)(a) of Law No 571/2003 on the Tax Code and transposing the provisions of the Directive, that the legal person should not be identified for VAT purposes, represent a further condition in addition to those expressly provided for in Articles 3 and 4 [of the Eighth Directive] and, if so, is a further condition of this kind permitted, having regard to Article 6 of the Directive?

Can Articles 3 and 4 [of the Eighth Directive] have direct effect, or does satisfaction of the conditions explicitly regulated by those provisions rather confer on the legal person not established in the territory of Romania, in accordance with Article 1, the right to refund of VAT, regardless of the form they are given in the national legislation?

In effect, the problem appears to be that a refund claim has been made by a person who has no "presence" in Romania but who has appointed a tax representative. The court will presumably determine whether the correct refund procedure is to complete a Romanian tax return, or to submit a direct claim to the authorities.

CJEU (Reference) (Case C-323/12): *E.On Energy Trading SE v Agenția Națională de Administrare Fiscală, Direcția Generală a Finanțelor Publice a Municipiului București – Serviciul de administrare a contribuabililor nerezidenți*

5. INPUTS

5.1 Economic activity

5.1.1 Horse trading?

A company purchased a single horse (called "For Fun") for £490,000, and claimed input tax in the period to October 2008 amounting to £73,000. HMRC denied deduction on the basis that no business was being carried on. The VAT 1 estimated the first year's taxable supplies as £500,000, but the actual turnover in the accounts was nil.

The Tribunal examined the company's history, which included a number of factors suggestive of a hobby rather than a business. These included a lack of a business plan; transfers of horses between the owner and the company that could not be expected to make a commercial return; and the apparent insolvency of the company as disclosed in the accounts.

The Tribunal noted the appellant's counsel's citing of the *Wellcome Trust* case as authority for the proposition that neither the scale nor the profitability of activities were relevant considerations in determining whether an activity is "economic", and *Rompelman* as authority for the contention that supplies do not have to be made immediately to justify regarding a business as existing now.

The Tribunal listed the "Lord Fisher" business tests, and concluded that none of them was satisfied. Even taking the widest possible interpretation of "economic activity" as contended for the appellant, this was no more than a hobby. The appeal was dismissed.

First Tier Tribunal (TC02243): *Goodman Equine Ltd*

5.1.2 Home electricity generation

The Austrian court has referred a question to the CJEU about the status of someone who produces electricity from solar panels. Presumably this could be of relevance in the UK if a person incurred VAT at 20% on the equipment and could account for 5% output tax on payments received from third parties – voluntary registration would result in input tax recovery.

Is the operation of a network-connected photovoltaic installation with no independent power storage capability on or adjacent to a privately owned house used for private residential purposes, which is technically designed such that the power generated by the installation is, on a continuing basis, below the total quantity of power privately consumed by the installation operator in the privately owned house, an 'economic activity' of the installation operator within the meaning of Article 4 of the Sixth Directive 77/388/EEC?

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

5.2 Who receives the supply?

Nothing to report.

5.3 Partial exemption

5.3.1 Updated toolkits

As reported in section 2.12 above, HMRC have updated their VAT toolkits which are made available for agents to help their clients complete accurate returns. As before, the toolkits are detailed questionnaires which examine the reliability of the systems which produce the VAT return, rather than checking the underlying data. They are certainly useful as a training tool and a systems design aid, as they highlight risks which a good system should address; however, they appear to be too unwieldy for most businesses to pay their agents to complete them.

The latest versions (dated 12 July 2012) deal with the risk areas on input tax in general, and on partial exemption calculations in particular.

http://www.hmrc.gov.uk/agents/toolkits/vat-partial-exemption.pdf

http://www.hmrc.gov.uk/agents/toolkits/vat-input-tax.pdf

5.3.2 Higher education institutions

HMRC have updated their framework for the design of HEIs' partial exemption methods. This has been revised to take account of changes to HMRC policy on the approval of "combined methods" for business/non-business activities and the extension of the Capital Goods Scheme to cover non-business activities from January 2011.

http://www.hmrc.gov.uk/menus/partial-exemp-frame.htm

5.3.3 Machine Games Duty and VAT

HMRC have issued an excise information notice (EIN 3/12) setting out their view of the implications for partial exemption calculations of the introduction of Machine Games Duty to replacement Amusement Machine Licence Duty in February 2013.

http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageVAT_ShowContent&propertyType=document&id=HMCE_PROD1_032241

5.4 Cars

5.4.1 Updated Notice

HMRC have published an updated version of their notice *Motoring expenses*. It is not obvious what has changed since the November 2011 version, and the new edition does not highlight the changes in policy on scale charges that was described in *R&C Brief 11/2012*.

Notice 700/64

5.5 Business entertainment

Nothing to report.

5.6 Non-business use of supplies

5.6.1 Pension scheme costs

A company acted as a trustee of a number of pension schemes where the employers had become insolvent. It engaged various professionals to assist with the administration of the schemes, the costs being borne out of the schemes' assets. It claimed a deduction of input tax of nearly £2.9m in relation to these professional fees. HMRC refused the claim, and an appeal was brought by the representative member of the trustee company's group.

The company argued that it incurred the VAT in the course of its taxable business, and the Tribunal should follow the earlier decision in *Capital Cranfield Trustees*. HMRC argued that the earlier decision had been wrong in law and should not be followed: either the VAT was incurred by the schemes, and not by the trustee, or else it was incurred by the trustee otherwise than in connection with any taxable output transactions.

The company also claimed that it should be able to rely on the principles of fiscal neutrality and legitimate expectation. It stood in the shoes of the insolvent employers, who would have been able to recover input tax on the costs of administering their pension schemes. HMRC did not accept that this was relevant, or that the FTT had jurisdiction to consider legitimate expectations.

The FTT applied the *Redrow* principles and decided that the professional services were received by the trustee in connection with its business. It accounted for output tax on its supplies of trustee services to the schemes, for which it raised invoices which were also paid out of the schemes' assets. In effect, the payment of the professional fees directly by the schemes was a short-cut: the position would have been clearer if the trustee had paid for the work and had claimed reimbursement, to which it would have been entitled, from the schemes. The Tribunal noted that the trustee would have been liable to pay the fees itself if a scheme became insolvent.

HMRC argued that the fees were in fact disbursements, properly the liability of the schemes themselves, and therefore not a cost component of any supply made by the trustee. However, the FTT did not accept that this was a correct interpretation of the contractual position.

In conclusion, the FTT noted that the decision would not benefit the trustee. If input tax was deductible because the costs were the trustees' costs, the payment by the schemes was in effect the meeting of the trustees' liability – there would be an output tax liability to match the input tax claim, and this had not yet been accounted for.

The questions of legitimate expectation and equal treatment were considered to be irrelevant. It was true that a scheme administered by the trustee was in a worse position than one with a solvent, fully taxable

employer; however, that arose from the different facts of the situation and the normal rules of VAT, not from any unfairness in the inconsistent application of the rules to similar facts.

First Tier Tribunal (TC02224): *JIB Group Ltd*

5.6.2 Private or business?

A surveyor carried out a number of property development projects, each one run through a special purpose vehicle company set up for that assignment. The business was cyclical, and for several years the surveyor had submitted returns showing no output tax. A control visit in November 2009 led to an assessment disallowing some of the input tax claimed. The disputed items fell under the following headings, which the Tribunal considered in turn:

- Invoices not addressed to Darragh House;
- Maintenance of "Redcar" telephone associated with alarm system;
- Car park charges;
- Subsistence expenses;
- Business entertainment;
- Miscellaneous.

The largest item was an invoice addressed to another of the surveyor's SPV companies. Although he claimed that the other company was fully taxable and VAT-registered, there was no doubt that the wrong company had claimed the deduction. The appeal was dismissed on this point. The chairman helpfully pointed out that the time limit for an input tax claim runs from when the claimant "holds" the invoice. This could be said, in these circumstances, to start when the surveyor realised that he would have to repay the VAT and therefore transferred the invoice across to be "held" by the correct SPV.

The surveyor gave evidence, which was not challenged by HMRC, that the particular burglar alarm arrangement was a requirement of his insurance policy and this arose because he ran his business from home. The chairman accepted that this created the necessary link between the maintenance of the alarm and the business, and the appeal was allowed in respect of this item. Any personal benefit was incidental to the business purpose.

HMRC challenged the deduction of VAT on airport car parking charges on the grounds that there was insufficient evidence of a business purpose. The chairman accepted the surveyor's oral evidence about these costs and allowed the appeal in this respect as well.

The appeal in relation to subsistence expenses was dismissed, mainly because it appeared that the trader's recollection was faulty (and the evidence was not produced in the Tribunal). He thought that the receipts were mainly for sandwiches at motorway service stations (which would presumably generally be zero-rated), while the officer's records suggested they were mainly from pubs and restaurants. The chairman discussed the conditions for claiming subsistence: "local" subsistence would not in any case be allowable, even if business was discussed at a meal between the

trader and an employee, but necessary meals while travelling on business could be claimed. The decision was made on the evidence rather than the principle.

The trader had also claimed 35% of VAT on entertainment expenses as "the subsistence element". He said that he had been told that this was the correct approach by HMRC. The chairman found that there was no such rule, and dismissed the appeal. The alleged advice from HMRC was not something that the Tribunal could consider.

The trader failed to produce any evidence to support the "miscellaneous" expenses, at least some of which was clearly disallowed because it was Portuguese VAT. The assessments for the earliest periods were estimated, so the chairman made a decision in principle and directed the parties to agree the final amount between them.

First Tier Tribunal (TC02105): *Darragh House Ltd*

5.7 Bad debt relief

5.7.1 Time limits and compliance with Directive

In early 2011, the Upper Tribunal heard an appeal and application by HMRC to have questions referred to the CJEU on the compatibility of the UK law on bad debt relief with EU law before 1997. The UT declined to make a reference, and it has now issued a decision in the substantive hearing. This has been combined with an appeal brought by BT on similar issues. An example of GMAC's argument was given as follows:

a. a customer agrees to pay £15,000 (plus interest) over the period of an hp agreement;

b. the customer stops paying when £10,000 is outstanding (having paid only £5,000);

c. the car is repossessed and sold at auction for £6,500 [this sale being "de-supplied" by the Cars Order 1992];

d. under the terms of the hp agreement the £6,500 is set against the outstanding £10,000 and the customer owes £3,500;

e. the customer then does not pay the £3,500.

4. At the time of the repossession, GMAC would already have accounted for VAT on the full (VAT-inclusive) purchase price of £15,000. It is entitled to adjust its accounts in respect of the reduction in the consideration, that is to say the amount at which the car is resold at auction, pursuant to Regulation 38 of the Value Added Tax Regulations 1995 ("the VAT Regulations 1995"). That adjustment does not, however, cover the amount remaining outstanding, and unpaid, by the customer, that is to say the £3,500. The appeal concerns whether GMAC is entitled to some form of VAT bad debt relief in respect of the £3,500 it does not receive.

GMAC is claiming over £2m for the period from 1978 to 1997, arguing that the requirements for the customer to be insolvent (up to 1990) and property in the goods to have transferred (up to 1997) were incompatible with EU law, and also the imposition of a time limit for claims in 1997 was unlawful because it did not provide for a transitional period.

In the preliminary hearing, the judge identified three separate issues – the "compatibility" issue and "time limit" issues described above, and also a "windfall" issue, under which HMRC alleged that the company would receive an unjustified benefit if its claim was granted. This was summarised "at a high level" by the judge as reliance on both the EU law (to justify the bad debt claim) and the Cars Order (to de-supply the onward sale of a repossessed vehicle) to produce a result that was neither provided for nor envisaged by either the EU law or the UK law.

The Upper Tribunal agreed with the First Tier Tribunal that the requirement for the customer to be insolvent was not a proportional response to the intended result of fiscal harmonisation. It was not even clear what the purpose of the property condition had been, and it did not affect the fact that a bad debt had arisen. The Directive gave the trader directly effective rights which had been denied, so the claim was valid in principle.

The UT also agreed with the First Tier that the transitional period from November 1996 to March 1997 had not been adequate, so the previous time limit should be treated as if it had never been repealed. The claims were therefore still in time. There was no need to refer a question about this to the CJEU, because the court would say that it was for the national courts to decide what was proportional. As the Upper Tribunal did not consider it to be so, that ended the matter.

However, the UT was not sure whether HMRC's "windfall" argument might have some validity in EU law. The interaction of bad debt relief, a claim to reduce consideration received, and the ability to reduce the consideration on the sale of repossessed vehicles led to an over-favourable result that could not be in accordance with the intention of the Directive. This could not be resolved without a reference to the CJEU. The judges will consider making a reference on the basis of submissions from the parties.

BT's claim was for bad debt relief of about £92m plus interest arising from January 1978 to March 1998. The UT applied the same principles in considering the time limit for making such a claim: as the introduction of the cap for bad debt relief in 1997 had been flawed, the old law continued until properly amended. The caps in s.80 VATA 1994 and s.121 FA 2008 had no application, because the claim was effectively made under s.22 VATA 1983. The claims were not time-barred when made in 2009.

Upper Tribunal: *HMRC v GMAC UK plc; British Telecommunications plc v HMRC*

5.8 Other input tax problems

5.8.1 MTIC appeals

In TC00687, a company was unsuccessful with an appeal against the denial of nearly £1.5m relating to VAT periods 03/06 and 06/06. The First Tier Tribunal did not consider that there was any direct evidence that the director had known that the transactions were fraudulent, but the lack of adequate due diligence procedures meant that he had failed to protect himself: if he had asked the proper questions, he would have realised what was happening, so he "had the means of knowing".

The trader appealed to the Upper Tribunal on the only ground permitted by the FTT judge in his decision: that the FTT failed to direct itself properly as to the meaning of "the only reasonable explanation for the circumstances being fraud" and took too broad an approach. The judge examined the FTT's decision and a number of UK and CJEU precedents, and concluded that the FTT was entitled to come to its decision based on the evidence before it. The appeal was dismissed.

Upper Tribunal: *NG International Ltd v HMRC*

A trader was denied a deduction of £865,000 of input tax in relation to 8 transactions in mobile phones in its June 2006 return period. The VAT 1 form, dated January 2005, stated "Mainly, this company has been set up with the intention of providing services such as building, painting, internally decorating." Investigating the buying and selling of wholesale electrical components was described as a secondary activity. By June 2005, the company had turnover of £17m in the quarter, and it appears that about £1m was repaid to it over four quarters until HMRC blocked the June 2006 return.

The normal consideration of the transactions led the Tribunal to the normal conclusion: that the only reasonable explanation for the uncommercial nature of the trade was a connection to fraud, and the director ought to have known this. The appeal was dismissed.

First Tier Tribunal (TC02085): *Comveen Ltd*

A similar conclusion was reached in relation to purchases of CPUs and mobile phones which led to claims for about £230,000 in the periods to July and August 2006. The deals were "too good to be true", and the directors were careless in failing to carry out checks appropriate to the risks inherent in the trade they had entered into.

First Tier Tribunal (TC02147): *Else Refining and Recycling Ltd*

Another case concerned a claim for about £1.4m in relation to 19 deals in April to June 2006. The appellant conceded that the transactions had been fraudulent, so the only question was whether the directors "knew or had the means of knowing" that at the time.

The Tribunal chairman listed out the many unsatisfactory aspects of the evidence given by the directors and their witnesses, and concluded that it was inconceivable that a "mastermind" could have organised the VAT fraud without the participants being aware of the pre-ordained role that they were required to play. The appeal was dismissed.

First Tier Tribunal (TC02214): *Gemini Media Group Ltd*

One appeal started with a long discussion of the history of the trader's delays, mainly through changes of representation, in proceeding to a hearing. The chairman observed that the Tribunal had been "extremely accommodating towards the appellant." At last, in December 2011, the hearing proceeded without the appellant or a representative. Even so, there was plenty of evidence from HMRC's files, and the Tribunal decision runs to 478 paragraphs. The usual conclusion was drawn: the director ought to have known that the transactions were connected to fraud, and the appeals were dismissed.

First Tier Tribunal (TC02106): *Lifeline Europe Ltd*

5.8.2 Questions about documentation

The Belgian court of first instance has referred questions to the CJEU on the rules for denying input tax credit:

Is a Member State entitled to refuse to allow a deduction in favour of taxable persons who are recipients of services and are in possession of invoices which are incomplete, but which have been supplemented by the provision of information seeking to prove the occurrence, the nature and the amount of the transactions invoiced (contracts, reconstitution of figures on the basis of declarations made to the national social security institution, information on the functioning of the group involved, ...)?

Must a Member State which refuses, on the basis of inaccuracies in invoices, to allow a deduction in favour of taxable persons who are recipients of services not find that the invoices are then also too inaccurate to allow payment of the VAT? Consequently, is a Member State not required, in order to safeguard the principle of neutrality of VAT, to repay the VAT which has been paid to it to the companies which supplied the services thus disputed?

This seems to reflect an unusual situation: the authorities appear to have found both parties to the transaction and might be required to repay output tax to someone who has raised an inaccurate invoice. The court appears to consider the invoice itself to be the important thing, whose inaccuracy might outweigh the proof of the details of the transaction from other sources. The answer to the question will be relevant for the operation of reg.29 SI 1995/2518, which authorises HMRC to accept alternative evidence in support of an input tax claim.

CJEU (Reference) (Case C-271/12): *Petroma Transports SA, Martens Energie SA, Martens Immo SA, Martens SA, Fabian Martens, Geoffroy Martens, Thibault Martens v État Belge*

5.8.3 Company car fuel advisory rates

The fuel-only advisory mileage rates used to change twice a year, but for 2011 and 2012 HMRC have changed the rates quarterly. The changes are generally very small – between June and September 2012, only the LPG rates changed.

The rates from 1 September 2012 (1 June 2012 in brackets) are:

Engine size	Petrol	LPG
1400cc or less	15p (15p)	11p (10p)
1401cc – 2000cc	18p (18p)	12p (13p)
Over 2000cc	26p (26p)	17p (19p)

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

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

5.8.4 Addition to s.33 and s.33A bodies

The Police Reform and Social Responsibility Act 2011 has abolished police authorities, which were able under s.33 VATA 1994 to reclaim VAT incurred in the course of their statutory duties. Chief Constables and the Commissioner of Police of the Metropolis have been added to the list by way of replacement.

SI 2012/2393

HMRC are also carrying out a routine review of the list of museums and galleries eligible for VAT refunds under s.33A VATA 1994. Two new institutions have been proposed by the Department for Culture, Media and Sports, and the existing list is being updated for changes of address, closures etc., and the removal of institutions which charge for admission (which can recover input tax according to the normal rules). Comments on their proposed amendments were required by 19 October.

www.hmrc.gov.uk/drafts/museums-order-draft.pdf

6. ADMINISTRATION AND PENALTIES

6.1 Group registration

6.1.1 Reminder on reverse charges

VAT Notes carries a reminder that new valuation rules for VAT group reverse charges were brought in by the Finance Act on 17 July 2012 (previously valuation was by concession under ESC 3.2.2 in Notice 48 Extra statutory concessions). They affect VAT groups that are partly exempt and have members with overseas establishments. Guidance on how the new rules apply in practice has been written and released to affected trade bodies.

VAT Notes 3/2012

6.1.2 Infringement proceedings

The Commission has made an application to the CJEU for a declaration that Sweden's grouping rules contravene the Directive in that they restrict grouping to companies in the financial sector. The Commission believes that the option given to member states does not allow them to be selective – grouping is either allowed for all undertakings in all sectors, or it is not allowed at all.

CJEU (Reference) (Case C-480/10): *Commission v Kingdom of Sweden*

The Commission has made another application to the CJEU for a declaration that Finland's grouping rules contravene the Directive in two respects: that they restrict grouping to companies in the financial and insurance sectors, and that they permit non-taxable persons to join a VAT group. Finland therefore joins a number of other member states which are subject to infringement proceedings on this second issue.

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

6.2 Other registration rules

6.2.1 Threshold test

A trader normally traded below the registration threshold. He did not monitor the level of trading because he did not expect to exceed the limit. In 2007 he was particularly busy and went over the threshold (at the time, £64,000). His accountant had formed the view that it was not necessary to check regularly because the turnover for the year to 31 March 2007 was only £49,000; but when he came to prepare the accounts for the year to 31 March 2008, he found that the turnover was £77,825. The accountant decided that this level of turnover was unlikely to continue, and therefore did not notify an obligation to register. The chairman described this as "substituting his own judgement for that of the Commissioners" that turnover would be below the deregistration threshold for the following 12 months.

In his consideration of the way the rules operate, the chairman comments:

This legislative mechanism imposes burdens on a trader who is not registered, for it requires (in paragraph 5(1)) him to notify HMRC within 30 days after the end of any month if he has become liable to be registered because his turnover has exceeded the threshold. Thus at the end of each month (say again 31 October) he needs to look back over the last 12 months to see if his turnover is more than £64,000. If it is he then needs to think about the 12 months starting on 1 December and ask what the situation is likely to be for that period. If he concludes that it is likely that his turnover will be less than £62,000 he then needs to acquaint HMRC with the position and to make sure that by 1 December HMRC have all the information necessary for them to share his view if he wishes to escape registration from 1 December. It is no use telling HMRC relevant facts on 2 December or any later date; he has to get the information to them by 1 December; and even if he does he will be to some extent in their hands if the information he provides is not such as to lead unequivocally to the conclusion that the turnover for the 12 months beginning on 1 December will be less than £62,000.

An alternative view is that it would be the 12 months from 1 November that would have to be considered, as the law refers to "the time at which, apart from this sub-paragraph, he would become liable to be registered". Although the effective date of registration would be 1 December, "the time at which the trader has become liable to be registered" is described in para.1(1)(a) Sch.1 VATA 1994 as the end of the month in which the historical turnover threshold is exceeded.

After the income tax return was submitted, HMRC asked for the monthly turnover from April 2006 onwards. This suggested that the threshold had been exceeded in the 12 months to October 2007. HMRC then asked for evidence that might have satisfied them that his turnover would not exceed £62,000 in the 12 months following the breach of the threshold.

In the event, the trader decided to register and submit VAT invoices to his principal customer, who was VAT-registered. Unfortunately, the customer then went into liquidation, so there was a bad debt which could not fully be covered by bad debt relief (the argument from the *Simpson & Marwick* case was not considered). He therefore tried to have the registration cancelled instead.

The Tribunal considered the main precedent case law (*Gray t/a William Gray & Sons v C&E*, HC 2000) and concluded that HMRC could only "be satisfied" under Sch.1 para.1(3) on the basis of information they actually held at the time, which they did not have because the trader had not notified them. The only information they actually held was the accounts for the previous year, which might have indicated that it was unlikely that turnover would exceed £62,000 in any year, but was not particularly relevant. The Tribunal held that the decision not to apply Sch.1 para.1(3) was "unreasonable" because it was based on information not held at the time – the accounts for the year to 31 March 2008.

Even so, the Tribunal dismissed the appeal for a different reason, and the trader seems bound to lose. Because he requested registration, thinking that it was a solution to the problem, he could not now reverse that. His representative claimed that it was not a "truly voluntary" registration, but it had been validly "requested" in the terms of the legislation, and

therefore could not be cancelled with retrospective effect. The appeal was dismissed.

First Tier Tribunal (TC02125): *Mark Mills-Henning*

6.3 Payments and returns

6.3.1 No retrospective withdrawal

A trader applied to join the Flat Rate Scheme on 26 August 2004. He was classified as a management consultant with one of the highest FRS rates. He subsequently diversified his business to include boat hiring and ship surveying (a zero-rated activity under VATA Sch.8 Group 8). The trader did not include his income from the zero-rated sales in his FRS calculations, and also failed to update the rate used for his VAT returns when the flat rates changed over the years.

When he finally realised that the FRS was seriously disadvantageous, the trader applied to be withdrawn from the scheme with retrospective effect, backdated to the start of the ship surveying activity. HMRC only agreed to give effect to the request from the date it was received.

HMRC's internal guidance suggests that retrospective withdrawal should only be accepted in "exceptional circumstances" for example compassionate circumstances or where the survival of the business is at issue. The trader did not seek to bring his case within either of those descriptions.

In the circumstance, the Tribunal could find no reason to regard HMRC's decision as unreasonable. The policy on retrospection had been approved by a High Court judge in the case of *HMRC v Burke* [2009], and this appeared to be a straightforward application of that policy. The trader was unfortunate in that the scheme allowed for winners and losers, and he should have paid closer attention to which side of that line he was on.

First Tier Tribunal (TC02086): *Northern Renovations Ltd*

6.3.2 Retrospective change of rate

By contrast, a trader won an appeal about a retrospective change to the FRS rate to be used. It had initially used the management consultancy rate but applied the following year to be able to change this to "business services not described elsewhere" (1.5% lower). The HMRC officer refused, applying the general policy on retrospection in the FRS.

The Tribunal examined the stated policy on such changes and concluded that it was not the same as for admission to or removal from the scheme. As described in Notice 733, it is as follows:

4.2 What if I get the sector wrong?

We will not normally check your choice of sector when we process your application. So if you have made a mistake you may pay too much tax or too little. Paying too little could mean that you are faced with an unexpected VAT bill at a later date.

However, if we approve you to join the scheme, we will not change your choice of sector retrospectively as long as your choice was reasonable. It will be sensible to keep a record of why you chose your sector in case you need to show us that your choice was reasonable.

This means that an error in classification will and should be retrospectively changed. It is not the exercise of a different choice by the taxpayer, but a correction.

The chairman also complained that HMRC could not provide a copy of Notice 733 that would have been current in 2008, and only a slightly hesitant assurance that it had not changed. Where an appeal turned on the validity of HMRC's decision-making process, it was essential to know the basis on which HMRC's decision had been taken.

First Tier Tribunal (TC02151): *AML Consulting Ltd*

6.3.3 Annual accounting scheme

The Annual Accounting Scheme (regs.49 – 55 SI 1995/2518) seems to be relatively rarely used. Although there is nothing particularly topical about it at this time, the lectures for this quarter include a review of the scheme, its advantages and disadvantages.

Notice 732

6.4 Repayment claims

6.4.1 Compound interest runs out of steam?

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

1. Where a taxable person has overpaid VAT which was collected by the Member State contrary to the requirements of EU VAT legislation, does the remedy provided by a Member State accord with EU law if that remedy provides only for (a) reimbursement of the principal sums overpaid, and (b) simple interest on those sums in accordance with national legislation, such as section 78 of the VATA 1994?

2. If not, does EU law require that the remedy provided by a Member State should provide for (a) reimbursement of the principal sums overpaid, and (b) payment of compound interest as the measure of the use

value of the sums overpaid in the hands of the Member State and/or the loss of the use value of the money in the hands of the taxpayer?

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

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

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

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

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

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

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

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

The full Court's decision, handed down in July, is one of those which hands responsibility to the national court. It is much briefer than the opinion, giving only a single combined answer as follows:

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

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

There is therefore still hope for Littlewoods, Grattan and similar claimants, but it depends on the domestic court applying the answer to the fourth question in the taxpayer's favour.

CJEU (Case C-591/10): *Littlewoods Retail Ltd v HMRC*

6.4.2 Another mail order claim

Related to the *Littlewoods* case is the *Grattan* dispute, which has now received an Advocate-General's opinion. The company sold goods by mail order through agents and paid them commission. No deduction from output tax was made in respect of the commission, as the agents were not VAT-registered. Following the *Marks & Spencer* case, it submitted a claim for overpaid output tax dating back to April 1973. HMRC accepted that the effect of art.11C1 6th Directive was to allow such a reduction from 1 January 1978 onwards, but did not agree that the Second VAT Directive contained an equivalent right.

The issue related to the crediting of commission to the agents' accounts which could then be used by the agents to purchase goods for themselves. This was not treated by the UK as a reduction in the selling price of the

goods that the agents bought, but a separate expense, outside the scope of VAT, representing the cost to Grattan of obtaining the agents' services.

The Advocate-General starts her opinion with the observation that "*United Kingdom undertakings are inventive. Their ingenuity in relation to complex sales methods has repeatedly occupied the Court with regard to VAT and led to important rulings with evocative names such as Naturally Yours, Elida Gibbs or, most recently, Loyalty Management.*"

After examining the now superseded law, she has broadly agreed with HMRC, opining that:

"*A taxable person does not have a directly effective right to treat the basis of assessment of a supply of goods as retrospectively reduced where, after the time of that supply of goods, the recipient of the supply received a credit from the supplier which the recipient then elected either to take as a payment of money, or as a credit against amounts owed to the supplier in respect of supplies of goods to the recipient that had already taken place*."

It seems that the retrospective adjustment of consideration was introduced by the 6th Directive but did not exist before that. From 1973 to 1978, the only basis for such a claim by Grattan would be that it had returned some of the consideration for the original supply; although it was for the referring Tribunal to determine whether this was the case, the Advocate-General suggests that it probably is not so, given the complex relationship between the agent, the mail order company and the customer. In relation to sales by the mail order company to third party customers (as opposed to the agents' own purchases), there is no chain of supply, so a payment by the mail order company to the agent cannot be a return of consideration paid by the agent for anything that the agent has purchased from the company.

CJEU (A-G) (Case C-310/11): *Grattan plc v HMRC*

6.4.3 Abusive claim?

A pair of connected companies entered into transactions in December 1997 which were similar to those considered by the CJEU in the *BUPA Purchasing* case – prepayments for future supplies of drugs and prostheses which were intended to preserve the benefit of the zero-rating of medical supplies made by private hospitals after a change to the law on 1 January 1998 would make them exempt.

One company (H) paid £10m to the other (S), which accounted for output tax of £1.489m. H claimed and was credited with input tax of that amount. The intention was that when S later purchased drugs from pharmaceutical companies to supply to H in satisfaction of the prepayment, S would be able to recover the input tax charged at that later time because it related to a taxable supply which had been made in 1997.

In December 2000, HMRC challenged the scheme, arguing that the prepayment did not represent payment for a supply. An assessment was made to recover the input tax from H, and S was advised to make a voluntary disclosure in respect of the output tax. This was accepted and the money repaid. The effect would be to cancel the 1997 VAT entries, leaving any VAT charged by pharmaceutical companies as irrecoverable by H after 1 January 1998.

Pending the CJEU hearing of the *BUPA* case, the assessment and disclosure were held in abeyance. After the decision was given in 2006, H dropped its appeal on the substantive issues. However, it continued to maintain an appeal against the assessment on the basis that HMRC had failed to raise an assessment in time. This was upheld by the Tribunal in 2008 (VTD 20,778). S maintained that it was entitled to repayment of the voluntary disclosure, because that had been made in time and was clearly valid.

HMRC objected on the grounds that the scheme and the claim were abusive; S would be unjustly enriched by a repayment; and as S had raised something purporting to be a VAT invoice, the VAT was due to HMRC (this ground was added after the Tribunal's decision on H).

The chairman ruled that the many arguments put forward by both sides were essentially irrelevant. The issue was a simple one of whether the paperwork had been completed by the two parties in time: S had made its claim by the limit, and HMRC had not raised their assessment by the limit. That determined the issue:

"*The fact that Healthcare and Services were originally seeking to effect an artificial scheme, and to enjoy thereby unintended advantages, does not have any continuing relevance once the scheme had manifestly failed, and once all steps were then being taken, and indeed all taken at the instigation of HMRC, to reverse the scheme. The fact in this case that thereafter one assessment was held to be time-barred, and that the other company's claim was made in time resulted entirely from the neglect and incompetence of HMRC in failing to serve their assessment on Healthcare in time.*"

The chairman nevertheless considered all the other arguments in some detail, presumably to provide material for an appeal if HMRC wish to pursue one, but agreed with the taxpayer that the timing issue "trumped" the substantive one – there was no doubt that the scheme was artificial and ineffective, but that was not enough to rescue HMRC from the effects of their incompetence.

First Tier Tribunal (TC02162): *St. Martin's Medical Services Ltd*

6.4.4 Permitted corrections

Under reg.35 SI 1995/2518, HMRC have the power to require a trader to correct errors which are not otherwise corrected in accordance with reg.34. No time limit is placed on HMRC's power by the regulation. The liquidator applied for judicial review of a decision by HMRC not to apply this provision to an error which was alleged to have been made by the company in accounting for output tax of some £720,000 one quarter early (February 2005 rather than May 2005). If HMRC directed that the timing error should be corrected, the company would still have been in time to make a s.80 claim in respect of the VAT which it alleged had been overpaid. As the operation of reg.35 is not an appealable matter under s.83 VATA 1994, the appeal had to proceed by way of an application for judicial review of HMRC's decision.

The company made supplies of accommodation to asylum-seekers, paid for by the Home Office. It accounted for output tax for some years, even though it was told by HMRC that its supplies were exempt. In particular,

it included large amounts of taxable turnover on the return for February 2005. When it went into liquidation in 2007, the liquidator found the records in considerable disorder, but he made a claim in April 2008 to treat the relevant turnover as exempt. This claim could be entertained in respect of the May 2005 period but not February. HMRC's application of the cap became the subject of protracted litigation which has so far reached the Upper Tribunal (by way of the Court of Appeal).

The judge commented that there was "something odd" about the assertion that the company had accounted for output tax in the February 2005 return in respect of transactions that it claimed had taken place and been invoiced in the following period. The liquidator had not given HMRC access to the company's books and records, and there was insufficient evidence at the hearing fully to understand what had happened.

The main problem for the liquidator was that, on their own argument, there was nothing wrong with the May 2005 return – the output tax should not have been shown on it, and was not shown on it. The judge could see no reason to force HMRC to "correct" the May 2005 return by making it wrong so that a s.80 claim could proceed.

The question remained of whether a reg.35 correction to the February 2005 return on its own could lead to a repayment, as there is no explicit cross-reference to the cap on repayment claims. However, the judge was satisfied that the cap would apply. If the return was corrected so that it showed the right figures, the taxpayer would have to ask for the money back, and that could only be a s.80 claim. It would be capped three years after the end of the return period.

The judgment considers in detail the precedent case of *Cardiff City Council* and the principles which HMRC should apply in deciding whether to exercise their discretion in making a decision to direct under reg.35. Although the regulation contains no reference to the cap, the existence of that cap both in s.80 and in reg.34 was held to be one factor which it was reasonable for HMRC to take into account in deciding whether or not an error should be corrected.

Upper Tribunal: *Capital Accommodation (London) Ltd (in liquidation) v HMRC*

6.4.5 Cash accounting and capping

The Tribunal has made findings of fact and provisionally allowed an appeal in relation to a trader submitting a return two and a half years late; however, submissions on the application of the law were invited, suggesting that HMRC may have another attempt to resist the claim.

The point at issue is how capping interacts with cash accounting. Cash accounting requires a trader to enter input tax in the VAT account when a supply is paid for, not on its normal tax point. One question is then whether the cap runs from the return period in which the normal tax point fell, or the period in which it ought under the rules of cash accounting to have been entered in the records. That was complicated in this case by the fact that the business moved from cash accounting to the "normal" rules between the period in which the disputed input tax was incurred and the period in which a claim was made.

The business had operated from premises on a trading estate, but following a decline in business the partners had locked the building and abandoned it, not collecting the post. HMRC failed to track them down for some time, during which estimated assessments were issued and not paid. Eventually a threat of bankruptcy forced them to engage an accountant to sort out their finances.

As the business declined, the partners became less able to pay their suppliers promptly, leading to delays in claiming input tax under the cash accounting scheme. The accountant advised them to change to the normal invoice basis of accounting for the late submitted return for the period to 05/07, which was received by HMRC on 3 December 2009. He prepared schedules of invoices on which input tax had not been claimed and entered invoices dated after 31 July 2004 on the 05/07 return. He believed that the three-year cap should apply to the due date of the return, not to the date that the return was submitted. HMRC allowed only the input tax incurred for periods after 1 March 2006.

HMRC pointed out that the input tax could have been claimed in the returns at the time, because the expenses were paid for by credit card – the partners appear to have ignored the cash accounting rules that treat input tax as incurred when the credit card voucher is made out, not when the credit card bill is paid. However, the accountant submitted that the claim he was making was for the adjustment required on changing from cash accounting to normal accounting; that adjustment properly fell in the period in which the change was made (i.e. 05/07), and that was within the capping period when the return was submitted.

The published decision stops very abruptly, and reasons are not given. It may be that further explanation will be given after the submissions on the law are received, or it may be that part of the decision is missing from the Tax Tribunals website.

First Tier Tribunal (TC02241): *Lakeside Collector Cards*

6.4.6 Fiscal neutrality claims

Isle of Man Customs & Excise have invited claims for overpaid output tax on gaming machines within their jurisdiction going back to 1 December 2007. It appears that Isle of Man VAT legislation drew the same distinction as German legislation between gaming machines in general (taxable) and those in a licensed casino (exempt), and in accordance with the *Linneweber* decision on fiscal neutrality, the authorities have accepted that this is untenable.

It is surprising that it has taken them this long to come to this conclusion, given that the *Linneweber* decision was handed down by the CJEU in 2005 and UK businesses have been arguing about it ever since. The law will be changed to exempt takings from gaming machines more generally from 1 February 2013.

Isle of Man Customs & Excise Release, 14 September 2012

6.5 Timing issues

Nothing to report.

6.6 Records

6.6.1 Amendments to forms and filing

HMRC have published regulations, fully in force on 15 October 2012, which enable businesses to make certain communications electronically. These include:

(a) an application under section 43B(1), (2)(d) or (3) of the Act (Groups: applications);

(b) a notification under regulation 5(1), (2) or (3) (registration and notification);

(c) an application under regulation 6(1)(d) (transfer of a going concern);

(d) a notification under regulation 10(1) or (4) (VAT representatives);

(e) an application under regulation 52(1) (annual accounting scheme: eligibility);

(f) a notification under regulation 54(2) (annual accounting scheme: termination);

(g) a notification under regulation 55(1)(d) (annual accounting scheme: termination);

(h) a notification under regulation 55B(1)(a) (flat-rate scheme for small businesses: notification of desire to join the scheme); and

(i) a notification under regulation 55Q(1)(e) (flat-rate scheme for small businesses: notification of decision to withdraw from the scheme).

The regulations also make provision for invoices to be raised under the anti-forestalling provisions for supplies of land and building services following 1 October 2012 – such invoices are to be raised within 45 days of the charge being triggered. They also contain the provisions which allow traders to use the Capital Goods Scheme to recover input tax on the original costs of self-storage facilities on which no input tax was claimed because supplies were exempt, and which are below the normal £250,000 threshold for the CGS.

SI 2012/1899

6.7 Assessments

6.7.1 Decision confirmed

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

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

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

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

(1) in failing to address and give adequate reasons for its decision that the assessments were made within the applicable time limits; and

(2) in deciding that the company was liable to be registered for VAT when its turnover was below the compulsory registration threshold.

The Tribunal examined the trader's arguments and rejected them on both grounds. The decision of the FTT, and the assessments, were confirmed.

Upper Tribunal: *Khan (t/a Khan Tandoori II) and another v HMRC*

6.7.2 Mix of sales

A trader was registered as a retailer of adults' and children's clothing from March 2005 until October 2010 when it transferred its business to another company as a going concern. In February 2011, a visiting officer examined the records, and subsequently formed the view that the standard rated takings had been understated – too many of the sales had been treated as zero-rated. There had been a significant increase in declared ZR sales after 2008 (from 10% to nearly 50%) without a corresponding increase in the purchase of ZR goods.

The trader had failed to keep detailed records that might have backed up his claims that he earned a higher mark-up on children's clothes. The figures appeared likely to be unreliable, and the officer was justified in his approach to calculating the likely shortfall in output tax. The assessments were confirmed as being to best judgement and reasonable in amount.

First Tier Tribunal (TC02091): *Mahir London Ltd*

The split between standard and zero-rated sales was also at issue in another case, this time involving a person who ran a confectionery stall on an underground station. The investigating officer, Mr Crisp, initiated his enquiries into her income tax profits, but this later extended to the VAT returns. The appellant could produce no evidence to displace the assessments raised by the officer, which appeared to be logical and were

therefore to best judgement. The appeals against the income tax and VAT assessments, as well as related penalties, were dismissed.

First Tier Tribunal (TC02171): *Mita Khagram*

6.7.3 Extended time limits

A builder was assessed outside the normal four year time limits for VAT dishonestly under-accounted for. The FTT agreed with HMRC's conclusions that deposits into his bank account showed that the turnover was higher than that declared on his returns, and that this indicated dishonesty. The assessments outside the normal time limits were justified.

It seems that HMRC only assessed for VAT and interest, without adding a penalty of any description – the trader ought perhaps to consider himself lucky.

First Tier Tribunal (TC02166): *Peter Lord t/a PML Building Services*

6.7.4 Till rolls

A supermarket was assessed to VAT and a s.60 penalty on the basis of a till roll taken away on a control visit that indicated underdeclarations over several periods. The total assessment was for VAT of £82,859, increased by a penalty of 80% – another £66,287.

The FTT examined the evidence, which included 24 hours of CCTV footage to provide evidence of the level of trade. It concluded that a particular "clerk 4" button had been deliberately used to suppress reported sales, and that someone in the business knew the amount of the "clerk 4 sales". The assessment had been made to the best of the officer's judgement, and the appeal was dismissed, except in relation to two periods in which it appeared that HMRC had sufficient information to raise the assessments over 12 months before they were issued. HMRC were given the opportunity to make further representations on this issue if they wished.

First Tier Tribunal (TC02170): *Bounds Green Supermarket (a partnership)*

6.7.5 Tax and VAT

In a dispute following an investigation leading to assessments for both income tax and VAT (with associated penalties), the Tribunal dismissed the trader's appeals, noting in particular that the investigation was characterised by a failure to provide information which was reasonably requested by HMRC. The penalties levied at 30% could have been higher.

First Tier Tribunal (TC02228): *Agnes Nelson t/a Sandvale Licensed Grocers*

6.7.6 No invoices

A trader carried on a business which made regular repayment claims. When HMRC investigated, the officer was given a number of different versions of events, including different identities of the business vehicle through which the trade was carried on. When an assessment was issued for £360,000 on the trader personally, disallowing input tax for which there appeared to be no evidence, he appealed. Among other arguments were the fact that the assessment was proper to the company, which had been liquidated; and that the purchase invoices had been lost in a helicopter crash which had left him paraplegic. The officer noted that, while accepting that he had been seriously hurt in a helicopter crash, the taxpayer was able to walk when he attended various meetings.

The appeal was dismissed, and the assessment confirmed as the liability of the individual.

First Tier Tribunal (TC02248): *David James Cummaford, Abcoma Ltd*

6.7.7 Article

In an article in *Taxation*, Neil Warren examines the possible consequences of an investigation into a cash-based business, with the likely allegation that takings have been understated. He considers the difficulties of any estimation exercise and the arguments that can be used to protect the trader against unjustified arithmetical conclusions.

Taxation, 20 September 2012

6.8 Penalties and appeals

6.8.1 Default surcharge appeals

A company claimed the benefit of s.108 FA 2009, which suspends default surcharge while a time to pay agreement is in force. The Tribunal agreed with HMRC that this did not assist the appellant, because the agreement had been entered into six weeks after the due date for the tax concerned. Some contact had been made with HMRC while an application for a bank loan was processed, but this did not constitute a formal application for a time to pay arrangement. In the circumstances, the length of time taken by the bank to process the loan was not a "Steptoe" reasonable excuse, because the directors should have foreseen that there would be a delay. The surcharge was £5,000 calculated at 15%.

First Tier Tribunal (TC02093): *Claremont Executive Services Ltd*

A company was required to pay its VAT by monthly instalments. It gave the bank a standing instruction to initiate the payment on the 25th of each month, which generally meant that HMRC had the money before the deadline of the last working day of the month. 25 February 2011 fell on a Friday, and the payment only reached HMRC on Tuesday 1 March. A surcharge of £2,503 was imposed.

The Tribunal did not accept that the "fine was disproportionate". It noted the circumstances which had led to the late payment, the fact that the

delay was a single day, and the fact that in most months HMRC received the money early, but the only error had been made by the taxpayer. The surcharge was not "manifestly unfair" in the circumstances.

The Tribunal also noted that the letter which set out the review decision, confirming the surcharge, was unhelpful in that it did not respond directly to any of the points raised by the taxpayer but simply confirmed the penalty in standard form. This was regrettable, but it could not be part of a defence as it was only written some time after the default.

First Tier Tribunal (TC02139): *McGee Group Ltd*

6.8.2 Late appeals

In 2008 the old VAT and Duties Tribunal (VTD 20,665) held that a VAT-registered trader who stopped one business and started another, trading below the registration threshold, was still liable to VAT on the new activity because he had failed to cancel his registration. His argument that the new business was carried on in partnership with his wife was rejected.

The trader was dissatisfied with the decision and continued to argue the point with HMRC, but as an appeal at that time would have lain only in the High Court, he did not pursue it. When eventually HMRC sent a final demand for the tax in early 2011, the trader formed the view that it would be possible and less risky to appeal to the Upper Tribunal.

This appeal was made long after the time limit for lodging an appeal had passed. The Tribunal considered whether there were any good reasons to allow the appeal to proceed, and rejected the application.

First Tier Tribunal (TC02089): *Martin David Talbot*

A club claimed a repayment of VAT on gaming machine income in August 2006. The rejection of this claim was communicated by letter in December 2006, and the club appealed in December 2010. The Tribunal could find no good reason for making an appeal nearly four years out of time, and struck out the application.

In common with many similar cases, the trader seems to have believed that the rejected claim would be held over pending the result of the *Rank* case without any need for further action. Whether this is true, or the trader had taken a positive decision to drop the matter, does not appear to concern the Tribunal. It is clearly necessary to make a "protective appeal" within the time limits, even if the trader intends to wait for someone else to argue the case.

First Tier Tribunal (TC02164): *Eltham Hill Club and Institute*

Another club made a claim for a *Rank* repayment that was rejected by HMRC as being out of time (it was received by HMRC on 1 July 2011). The club argued that it had been given inappropriate advice by the Debt Management Unit in Glasgow when it enquired about making a claim in 2006/07; if it had been given the correct information, it would have made a proper claim in time and would have appealed the decision to refuse the claim.

Whatever the reasons for the lateness, the claim was hopeless, because the cap would have to be applied. The application was struck out.

First Tier Tribunal (TC02252): *Kirkshaw's No.1 Social Club*

A trader was assessed for a number of different tax and VAT periods, as well as surcharges and penalties, in relation to allegedly undeclared income from a livery and horse blanket business. He eventually appealed to the Tribunal, only to be told that he was out of time. He claimed not to have realised that he had to appeal, as HMRC were continuing to ask him for information and to reduce the tax demanded; however, the Tribunal agreed that decisions had been made and he had no good reason for failing to appeal against them formally. Even if he had started with that misunderstanding, there was no doubt that he was given clear notice that he needed to appeal in February 2010, and he still did not do so for another 9 months.

First Tier Tribunal (TC02210): *Stuart Bell*

6.8.3 Costs

A trader was partially successful in an appeal against default surcharges (TC01568) on the grounds that there was a reasonable belief that a time to pay arrangement was in force. It then applied for costs. The Tribunal considered the rules for an award of costs, in particular the period during which recoverable costs could be incurred in relation to "proceedings" and the period in which HMRC's behaviour was relevant (while the proceedings were being carried on or defended, rather than before or after the matter was in the hands of the Tribunal). The chairman concluded that HMRC had not acted unreasonably in relation to the proceedings, so the application for costs was refused.

First Tier Tribunal (TC02071): *G Wilson (Glaziers) Ltd*

A company was assessed in 2008 on the basis that it had overclaimed input tax. It appealed, but before the case reached the Tribunal, HMRC withdrew the assessments. The company claimed costs, but the Tribunal refused to award any, holding that HMRC had not behaved unreasonably. The initial notice of appeal had not set out any technical grounds for disputing the assessments, but had relied on an assertion of misdirection. In those circumstances, it was not unreasonable for HMRC to maintain their position. The fact that HMRC eventually decided that there were technical issues with the assessments, and that they were out of time to raise corrective ones, did not make their previous actions unreasonable.

First Tier Tribunal (TC02195): *Zanaco Investments Ltd*

6.8.4 Late registration

A trader took over a hotel as a going concern. HMRC notified a penalty for failing to register for VAT; she protested that she had sent the forms to her accountant within the time limit, whereupon HMRC reduced, but did not cancel, the penalty. The Tribunal analysed the situation as follows:

(1) That the appellant did not post her registration form on 26 November 2010, but in fact posted it in early March 2011. In short, that she has lied about when she posted them.

(2) That delivery of the posted form was delayed by the Royal Mail.

(3) That the form was posted as the appellant says and delivered in due course of post, but not properly logged and dealt with once it arrived at the respondent's premises.

Situation (2) would constitute a reasonable excuse, because the trader would have an honest and reasonable belief that she had complied with her obligations. Situation (3) would clearly not warrant a penalty. In order to sustain the penalty, HMRC needed to adduce some evidence that the true situation was (1), and they had failed to do this. The registration form itself was dated 24 November, consistent with the date the appellant said she posted it; there was no reason for her to have delayed putting it in the post. Accordingly, HMRC had failed to show that the default had occurred, and the penalty was cancelled.

First Tier Tribunal (TC02205): *Paula Thorne*

6.8.5 Mitigation

An unusual ground for mitigation succeeded in a case in which a painter had failed to register for VAT in January 2007. When HMRC discovered this in 2011, a late notification penalty was imposed. The trader argued that he had accounted for too much income tax as a result of his failure to register for VAT – because of a change in the income tax law on corrections which took effect on 1 April 2011, he was no longer able to reclaim this overpayment. The extra income tax (£2,593) was treated by the Tribunal as sufficient to mitigate the VAT penalty (£1,905) by 100%.

Sir Stephen Oliver noted that the overpayment of income tax and the VAT penalty arose from the same error; HMRC were better off by £600 as a result even if the penalty was reduced to nil; and if they had noticed his failure to register promptly after submission of the income tax return for 2006/07, the trader would not have been affected by the change of law on income tax repayments.

First Tier Tribunal (TC02172): *R Wells*

6.8.6 Appeals procedure

A company failed to appear and was not represented at a FTT hearing in August 2011, at which its appeal (concerning refusal of input tax claims for £3.75m in 2005/06, not surprisingly involving mobile phones) was struck out. The curious thing about this is that the strike-out was for failure to pay HMRC costs of just £700 which had arisen after an earlier appeal application had been made and then withdrawn; the Tribunal had issued a direction in September 2009 that these costs should be paid within 14 days or, in default, the appeal would be struck out. The director appeared to have carried on a long correspondence which delayed the payment of the costs until June 2011.

The company applied for reinstatement out of time, and failed to convince the FTT that there was sufficient good reason for its conduct. The director had had other things on his mind while his father, who lived in Dubai, was terminally ill; however, the appeal had been in progress for a long period, and there had been little action before or after his father's last illness and death. The application to reinstate was refused.

First Tier Tribunal (TC02233): *Globalised Corporation Ltd*

In another MTIC-related dispute, the trader applied to stand over the appeal hearing pending the outcome of the CJEU cases of *Mahabegen* and *David*. The chairman summarised the possible relevance of the cases as follows:

Mahagében concerns a timber trader in possession of otherwise valid VAT invoices for the supply of logs where the Hungarian authorities considered the alleged supplier could not have fulfilled the order and sought to deny the right to deduct input tax on the basis that the invoices could not be regarded as authentic. Dávid raises the question of whether the right to deduct input tax can be denied on the basis that the issuer of an invoice for the construction of a dam could not guarantee the involvement of further subcontractors and such that the invoices they had issued complied with the requisite formalities.

The Tribunal concluded that there was only a low probability of these cases providing material assistance in determining the present appeal. There would be very little in wasted effort if the decisions did change the arguments, because most of the "evidence round" had already been completed. Even though the CJEU decisions might be given as early as October 2012, staying the proceedings to wait for them would create a further delay and would increase the risk of evidence becoming stale and deteriorating. In all the circumstances, the Tribunal concluded that it would not be fair and just to stay the proceedings.

First Tier Tribunal (TC02250): *Gandalf IT Ltd and related appeal*

The FTT has heard a follow-up to the decision in TC00775, which was reported in the January 2011 update.

An individual was involved in a long-running dispute over whether she was properly registered for VAT and therefore entitled to recover input tax. This appears to have originated in connection with a property transaction which may have involved a sale of land to the local authority (potentially a business transaction), or may have involved the individual receiving compensation following a lawsuit against the previous owners of the property (outside the scope).

In the first hearing, at which the taxpayer appeared in person and was not represented, the Tribunal examined the history of the dispute and the activities put forward in support of her claim for input tax. Applying the "Lord Fisher" tests, the chairman concluded that she was not in business and HMRC were correct to cancel her registration.

Then in TC01998, at which the taxpayer was neither present nor represented, the FTT dismissed an appeal against information notices concerning income tax issued under Sch.36 FA 2008. This hearing had been postponed twice to enable the taxpayer to recover from a knee injury; in the event, she was still unable to attend, and declined the opportunity to "appear by telephone".

The FTT on this third occasion ruled: "*It is clearly not in the interests of justice to set aside a decision that was correctly decided simply because one of the parties is not present. Mrs Lee's request for the decision to be set aside does not provide any reason why the FTT might have reached a different decision if Mrs Lee had attended the hearing. In conclusion, the application for the decision to be set aside is refused.*"

First Tier Tribunal (TC02116): *Priti Lee*

6.8.7 Regulatory penalties

The government has announced its conclusions from the June 2011 consultation on the possible simplification of regulatory tax penalties. The respondents supported simplification, but suggested that reform should go beyond what was envisaged and take into account the behaviour of the defaulters, many of whom had only incurred a penalty because they were unaware of their obligations. The government has announced that there is insufficient benefit for "customers" to warrant Finance Bill space for such an extensive reform at this time, so it has been deferred until "an appropriate opportunity presents itself".

http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageVAT_ShowContent&propertyType=document&columns=1&id=HMCE_PROD1_032141

6.9 Other administration issues

6.9.1 Negligence claim against advisers

A UK company traded in mobile telephones. In September 2003, following the introduction of anti-MTIC measures by HMRC the previous month, the company appointed KPMG to help ensure that it could recover VAT on its transactions. It subsequently applied for a loan from a third party, and provided documents to that third party to show the due diligence procedures carried out by itself and KPMG. KPMG's engagement letter specifically ruled out the creation of any third party rights. The loan was granted and advanced to a Delaware corporation subsidiary of the UK company. Later HMRC refused all the company's input tax claims and it went into liquidation. The lender sued KPMG; it fell to be decided whether KPMG owed a "duty of care" to the lender sufficient to create legal liability to compensate it for its loss.

KPMG applied for the case to be thrown out, and this application was granted. It was clear that the firm had not accepted responsibility towards third parties; it would not be fair, just or reasonable to impose an unlimited liability on the firm in such circumstances. No "reasonable businessman" would have expected the firm to stand behind a client in such a way, so the firm could not be held to have caused the lender's loss.

High Court: *Arrowhead Capital Finance Ltd (in liquidation) v KPMG LLP*

6.9.2 HMRC annual report

HMRC have published their 2011/12 annual report and accounts. The report claims improvements in performance in all areas, including compliance, customer service and prevention of fraud, as well as tax revenue collected (£474bn).

www.hmrc.gov.uk/about/annual-report-accounts-1112.pdf

6.9.3 New guidance on non-business clearances

HMRC have issued an updated version of CAP 1, which explains when and how non-business "customers" can obtain a binding ruling from HMRC. The only change does not relate to VAT, but to an application for clearance in relation to a new business investment relief introduced for non-UK domiciled individuals in FA 2012.

http://www.hmrc.gov.uk/cap/cap1.htm

6.9.4 New guidance on starting out

HMRC have announced a new e-learning tutorial aimed at farmers who are "Starting your own business". It sets out the basic tax compliance obligations in the context of farming, but the principles should apply to most other infant businesses as well. It covers:

- an overview of tax, National Insurance contributions and VAT;
- information on registering as self-employed;
- guidance on keeping business records;
- help with completing tax returns;
- information on paying HMRC.

HMRC (NAT) 65/12; www.hmrc.gov.uk/courses/syob/farm/index.htm

6.9.5 ADR pilot changes

HMRC announced a change to the trial of Alternative Dispute Resolution which is running throughout 2012/13 (HMRC's guidance notes were covered in the last update). The trial will now also consider applications where an appealable decision has been made by HM Revenue & Customs and will continue to accept applications until at least 30 November 2012.

http://www.hmrc.gov.uk/adr/index.htm

6.9.6 Tax consultations

The government has announced a new consultation entitled "lifting the lid on tax avoidance schemes". They are considering ways to improve the information available to HMRC about avoidance schemes, which include the revision and extension of the Disclosure of Tax Avoidance Schemes (DOTAS) provisions. The consultation runs until 15 October 2012.

The proposals are concerned to make sure that HMRC receive better information sooner, and would remove some of the possible reasons for a scheme promoter being able to defend non-disclosure. Detailed suggestions are put forward for the amendment of the "hallmarks" which indicate that a scheme falls within DOTAS.

This has been described by David Gauke, Exchequer Secretary to the Treasury, as a crackdown on "cowboy" tax advisers who promote contrived and aggressive schemes. The following extract from a recent speech by David Gauke at Policy Exchange contains some interesting information about the government's views and statistics on tax avoidance:

First, it is important to recognise the scale of the problem. Last year, HMRC collected £474 billion in tax. The tax gap – the difference between

what is owed and what is collected – is about £35 billion. Tax avoidance (as opposed to tax evasion, the hidden economy, criminal attacks and other aspects of the tax gap) accounts for just 14% of this gap – around £5 billion or about 1% of total liabilities. While that may be too high – being as it is more than zero – evidence suggests it's probably one of the lowest in the world. That's because, contrary to some claims, the vast majority of UK taxpayers do not aggressively avoid tax; and yes, that includes the vast majority of wealthy individuals and multinational corporations, as well as the vast majority of ordinary working people and small businesses.

If anyone is tempted to believe that tax is optional for the wealthy, remember that the top 1% of individuals by income pay 26% of all income tax, and the top 0.1% (just 30,000 individuals) pay around 11%. Large businesses pay around 60% of all taxes in the UK, but account for around only a quarter of the estimated the tax gap.

HMT 64/12

Meanwhile, an article in the Sunday Times suggests that Barclays Bank are engaged in a dispute with HMRC over an alleged scheme to avoid VAT on outsourcing IT work to India and the Philippines. According to the article, a whistleblower has accused the bank of trying to avoid a £4.6m VAT cost after transferring some 1,400 staff to Accenture and then taking them back on secondment. It is not

Sunday Times, 8 July 2012

The Treasury constantly updates its "tax consultation tracker". The following are relevant, directly or indirectly, to VAT:

Consultation title	*Description*	*Type*	*Timing*
VAT: addressing borderline anomalies	Consultation on draft secondary legislation to simplify the VAT rules.	Formal	Closed 18 May Response issued 28 June 2012
VAT: road fuel scale charges	Consultation on changing UK law to comply with EU law and on streamlining the scheme.	Informal	Closed 20 July
VAT relief for European Research Infrastructure Consortia (ERICs)	Consultation on draft secondary legislation to be introduced to provide VAT relief on a supply of goods or services to an ERIC.	Informal	Closed 30 June
VAT: Changes to VAT invoice rules	Consulting on changes to existing UK VAT invoice regulations to reflect the changes introduced by Council Directive 2010/45/EU.	Informal	Closed 12 July
VAT: freight transport services	Consultation on draft legislation.	Informal	Closed 31 August
VAT: exemption for education providers	Consultation to establish how to apply a VAT exemption to degree courses provided by commercial providers of Higher Education that adhere to BIS` regulatory framework ensuring they align with	Formal	Open for comment 12 September to 5 December

	the VAT treatment of similar courses provided by traditional universities.		
VAT treatment of small cable-based transport	A consultation on the implementation, impact, administrative burdens and proposals for evaluation relating to the introduction of a reduced rate of VAT for small cable-based transport.	Formal	Open for comment 17 July – 17 October
ANTI-AVOIDANCE MEASURES			
Lifting the lid on Tax Avoidance Schemes	Consultation on extending the DOTAS hallmarks so as to capture avoidance schemes that do not currently have to be notified.	Formal	Open for comment 23 July – 15 October
General anti-abuse rule	Consultation on new draft legislation to introduce a general anti-abuse rule.	Formal	Closed 14 September
TAX ADMINISTRATION			
Simplification of regulatory penalties	Consultation on repealing unnecessary regulatory penalties and a general power to revalorise others.	Formal	Published in June 2012

This is an extract from the version dated 21 September 2012 on the Treasury website.

http://www.hm-treasury.gov.uk/d/tax_consultation_tracker.pdf

6.9.7 Finance Bill progress

Two articles in *Taxation* reviews the Public Bill Committee's debates about the Finance Bill 2012. The 15th sitting, which was about the VAT measures, produced the liveliest debate. The final debate considered the revised changes after the "borderline anomalies" consultation had been concluded.

Taxation, 25 July 2012; 16 August 2012

6.9.8 VAT investigations increase?

The Daily Telegraph reports that the UK's largest companies have paid a total of £1.34bn in VAT after HMRC enquiries into avoidance schemes in the 2010/11 tax year, up from £443m in 2009/10. This may signal an increasingly aggressive approach as the government attempts to close the "tax gap" it has identified.

The number of businesses investigated also rose by 42% in the same period.

The Daily Telegraph, 30 July 2012

Meanwhile, HMRC issued a reminder that those taking part in the "Electricians Tax Safe Plan" had to pay their undisclosed tax liabilities by 14 August to take advantage of the lower penalties on offer...

HMRC release 6 August 2012

...and has started a new campaign on 26 September 2012 aimed at direct sellers (e.g. door-to-door, mail order agents, party plan sellers). They will need to notify HMRC and pay any undeclared tax by 28 February 2013 in order to qualify for the usual favourable penalty terms.

HMRC release 26 September 2012

6.9.9 Convictions

A missing trader gang of 15 people have been convicted of trying to claim £176 million of VAT on non-existent telephones in 2005/06. It appears that claims totalling £105 million were paid before the fraud was detected, and officers are now trying to recover the proceeds that were laundered through offshore accounts and a chain of ghost companies in other EU countries. The ringleader was sentenced to 17 years in jail.

The Guardian, 9 July 2012

The Cabinet Office website reports the conviction (and photograph) of a trader who claimed £75,000 in VAT repayments on the basis of invoices from companies which did not exist. He pleaded guilty and was sentenced to 16 months' imprisonment.

http://rnn.cabinetoffice.gov.uk/Press-Releases/Porn-magazine-distributor-jailed-for-VAT-fraud-67f14.aspx

A company which was allegedly involved in a carbon trading VAT fraud became insolvent. The liquidators sued the directors and the counterparty companies in the transactions for defrauding the company by acting in a way that would leave it unable to meet its obligations to HMRC.

The directors resisted the claim first on the grounds that the company could not sue on the basis of its own wrongdoing (i.e. it had been a party to the fraud). The court dismissed this, holding that the company was a victim, not a participant.

The counterparties resisted the claim on the basis that it was brought under s.213 Insolvency Act 1986, a UK provision which could not be applied across national boundaries. They claimed that the effect of the lawsuit was to pursue "the revenue debt of a foreign state", and the UK court would have no jurisdiction to enforce this. The court also rejected this contention, holding that the trade had been carried on fraudulently and that the debt was due to the UK revenue, not to a foreign state.

Bilta (UK) Ltd (in liquidation) and others v Nazir and others

6.9.10 Updated Notice

HMRC have twice updated their Notice on *Insolvency* in May and in July 2012. The first version in May included revised monetary limits for evidence to support post-deregistration input tax claims on form VAT 426 and a new contact point for partial exemption queries. The only change in July appears to be the updating of the help desk phone number at the HMRC National Insolvency Unit in Liverpool.

Notice 700/56

6.9.11 Compliance check factsheets

HMRC have expanded their range of factsheets which they give to people who are subjected to a compliance check, mainly by subdividing general factsheets into more specifically targeted documents. The new ones include:

- CC/FS1a: General information about compliance checks (a very brief document);
- CC/FS1b: General information about checks by Compliance Centres;
- CC/FS1c: General information about compliance checks into large businesses (also brief but with information more likely to be of relevance to a business with a turnover or £30m or more or at least 250 employees);
- CC/FS1d: General information about compliance checks into Excise matters;
- CC/FS7a: Compliance checks series – Penalties for inaccuracies in returns or documents;
- CC/FS7b: Compliance checks series – Penalties for not telling us about an under-assessment (these two factsheets give information about how to reduce the amount of any penalties);
- CC/FS20: Compliance checks – VAT and old penalty rules (because of the time limits that apply, this now only deals with s.60 penalties, and replaces Notice 161).

6.9.12 Security

A trader appealed against a notice requiring deposit of security of £55,000 (to be reduced to £47,600 if the trader agreed to file monthly returns). The decision had been made by one officer and confirmed on review by another; the Tribunal emphasised that its only jurisdiction was to consider whether they had acted reasonably on information made available to them at the time. The trader provided a number of arguments at the hearing that had not been put forward earlier; whether or not they should be taken into account (the FTT was doubtful whether "delayed repayments of other taxes due from HMRC" was a relevant factor), they could not have affected the reasonableness of decisions that were taken without the trader raising them.

Even with the benefit of the extra information, it appeared that the poor compliance record of the trader, and the involvement of its sole director with a previous company that had been liquidated owing HMRC a substantial amount of money, would have justified the decision.

First Tier Tribunal (TC02177): *Sturminster Construction Ltd*