VAT UPDATE
OCTOBER 2016

Covering material from July – September 2016

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1. INTRODUCTION

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

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

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

1.1 Appeals pending

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

The HMRC website section says that it will be updated "on a monthly basis", but it appears to be less frequent or regular than that. The latest update appeared on 6 September 2016, after a gap since April 2016.

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

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

1.1.1 UK appeals awaiting hearing or decision

- *Associated Newspapers Ltd*: HMRC have appealed to the CA against the UT's decision that SI 1993/1507 did not apply (hearing listed for December 2016).
- *BPP Holdings*: HMRC have been granted permission to appeal to the Supreme Court against the CA's ruling that the FTT was correct to bar HMRC from further participation in the proceedings.
- *HMRC v Bratt Auto Contracts Ltd and another*: taxpayer has been granted permission to appeal to the CA against the UT's ruling that its *Fleming* claims did not meet the statutory requirements for claims to be recognised, and therefore missed the 31 March 2009 deadline (hearing to take place before 18 July 2017).
- *Brockenhurst College*: CA has referred questions to CJEU about application of education exemption to meals supplied to third parties in order to train students in waiting and cooking.

- *C Jenkin & Son Ltd*: both sides have appealed a FTT decision in which HMRC assessed to disallow input tax on the basis that the company made exempt supplies, but the FTT held that the assessment was invalid because it should have charged output tax.
- *CCA Distribution Ltd*: the UT remitted matters in dispute back to the FTT; an oral permission hearing for an appeal to the CA is listed for 18 October 2016.
- *The Chancellor, Masters & Scholars of the The University of Cambridge*: HMRC have been granted leave to appeal against the UT's decision that VAT incurred on investment management was residual input tax of the whole operation (hearing listed January 2017).
- *Colaingrove Ltd*: HMRC's list used to contain four separate appeals, but this has been reduced to just TC02534 (fuel – UT decision in favour of HMRC that the lower rate did not apply because there was a compound supply of "caravan with electricity"); the company has been given permission to appeal to the CA, hearing set for February 2017. The cases about removable contents/definition, removable contents/apportionment and verandas are now resolved.
- *Dynamic People Ltd*: HMRC sought leave to appeal Judge Bishopp's FTT ruling that a special method continued until it was cancelled, even though the company had joined a group; the FTT decided to set aside its decision and rehear the case.
- *E Buyer Ltd and Citibank NA*: HMRC are seeking leave to appeal to the CA against UT's confirmation of FTT ruling that HMRC's statements of case were inadequate – they have to explicitly plead fraud or not suggest it at all.
- *Finmeccanica Group Services SpA*: taxpayer has been given leave to appeal to the Court of Appeal against the UT's ruling that it was making supplies in the UK and was therefore not entitled to a refund under the 8th Directive (hearing listed for October 2016).
- *GMAC UK plc v HMRC*: the UT reaffirmed its own decision in favour of the taxpayer on the basis of the CJEU decision (Case C-589/12). HMRC appealed to the CA (hearing 28/29 June 2016, decision awaited).
- *IFX Investment Co and others ("Spotting the Ball")*: HMRC are seeing leave to appeal the CA's ruling in favour of the company, holding that it was supplying exempt games of chance.
- *Investment Trust Companies (in Liquidation) v HMRC*: after the CA effectively reversed the High Court's decision in relation to the companies' direct claims for overpaid VAT, both parties appealed to the Supreme Court (hearing concluded 19 May 2016, judgment reserved).
- *Kati Zombory-Moldovan t/a Craft Carnival*: HMRC have been granted leave to appeal to the Upper Tribunal against the FTT's ruling that the trader was making exempt supplies of land.
- *Littlewoods Retail Ltd*: HMRC have been granted leave to appeal to the Supreme Court against the CA's decision in favour of the

company on the question of compound interest on long-term repayments. HMRC are appealing on both liability and amount, hearing listed for 3 – 6 July 2017.

- *Mercedes-Benz Financial Services*: HMRC appealed the UT decision that the company's product was leasing rather than HP to the CA, which decided to refer questions to the CJEU (questions in this update).
- *Metropolitan International Schools*: HMRC have been granted leave to appeal to the UT against the FTT's decision that the taxpayer supplied predominantly printed matter with incidental services (hearing listed for February 2017).
- *MG Rover Group Ltd*: HMRC have been granted leave to appeal against the FTT's decision about who is entitled to claim a refund where an overpayment was made on a group VAT return (hearing 5 – 12 July 2016, decision awaited).
- *Newey t/a Ocean Finance*: HMRC have been granted leave to appeal to the Court of Appeal against the UT's decision that the FTT was correct to find that the appellant's offshore business arrangements were not an abusive practice, hearing listed for March 2017.
- *Privin Corporation Ltd*: the FTT found in favour of a MTIC appellant. HMRC have been granted leave to appeal to the UT (hearing listed for November 2016).
- *SAE Education Ltd*: the company will appeal to the CA in June 2017 against the UT's ruling (in this update) that the FTT was wrong to allow exemption to the taxpayer as a "college of a university".
- *Taylor Clark Leisure plc*: HMRC are seeking leave to appeal against the Court of Session's ruling (in this update) that the company was entitled to a repayment based on a claim made by a former member of its VAT group registraiton.
- *Temple Finance Ltd and Temple Retail Ltd*: HMRC have been granted leave to appeal against the FTT's ruling that, in the main, Sch.6 para.1 directions were not possible and the standard method override did not apply.
- *United Grand Lodge of England v HMRC*: taxpayer will apply for leave to appeal to the CA (commencing 9 November 2016) against the UT's confirmation of the FTT's decision that it did not qualify as a body with philosophical, philanthropic or civic aims.
- *Victor Dunlop*: HMRC have been granted leave to appeal to the Upper Tribunal against the FTT's decision that part of a garage conversion qualified for a DIY claim. The list says "Upper Tribunal hearing vacated", so it is not clear what is happening.
- *Volkswagen Financial Services Ltd*: HMRC have been granted leave to appeal to the Supreme Court against the CA's ruling that VWFS's proposed special method was more fair and reasonable than HMRC's proposal (hearing listed for November 2016).
- *Wakefield College v HMRC*: the college has applied for leave to appeal to the CA against the UT's ruling that it would use its building

for a business purpose and therefore did not qualify for zero-rated construction.

- *Wheels Private Hire Ltd*: HMRC are appealing the FTT decision that a taxi firm made separate supplies of exempt insurance to drivers who paid taxable rent for radios.

1.1.2 Unresolved cases not on the list

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

- *Copthorn Holdings Ltd*: HMRC were refused (by the FTT) leave to appeal against the FTT's decision that they should reconsider their refusal to allow retrospective grouping. They have decided not to apply to the UT for permission; it remains to be seen what will happen next, because the decision of the FTT required HMRC to consider again their original decision.
- *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 (now awaiting a Supreme Court ruling after the HC and CA both applied the CJEU's judgment in Case C-591/10 in favour of the taxpayer).
- *Wilton Park Ltd*: company will appeal to CA against FTT and UT decisions that its charges to dancers for redeeming "Secrets Money" were standard rated (hearing listed for 5/6 October 2016).
- *Whistl UK Ltd*: the Court of Appeal will hear a further application for judicial review after the High Court held that the UK's amendments to the VAT exemption for postal services were compatible with EU law (hearing April 2016).

1.1.3 Cases in the current update

The current update includes the latest developments in the following cases from HMRC's list or previous outstanding lists in this update:

- *British Film Institute*: CA referred questions to CJEU about application of cultural services exemption in the early 1990s before UK implemented it properly (A-G's opinion in this update).
- *Caithness Rugby Football Club*: the Upper Tribunal dismissed HMRC's appeal against the FTT's decision that a new building was similar to a village hall.
- *DPAS Ltd* (in the current update): HMRC had a partial success in the UT, which stood over another point behind the CJEU decisions in *NEC* and *Bookit*. Now those decisions have been received, the UT has decided to refer *DPAS* to the CJEU as well.
- *Longridge on the Thames*: the CA upheld HMRC's appeal against the decisions of both the FTT and the UT that a charity's building was used for non-business purposes.

- *Pacific Computers Ltd*: the FTT found in favour of a MTIC appellant. The UT has allowed HMRC's appeal and remitted the case to a differently constituted FTT for reconsideration.
- *R (on the application of ELS Group Ltd) v HMRC*: the CA has refused the taxpayer's application for judicial review of HMRC's decision not to allow use of the staff hire concession for supplies of staff.

2. OUTPUTS

2.1 Scope of VAT: linking supplies to consideration

Nothing to report.

2.2 Disbursements

Nothing to report.

2.3 Exemptions

2.3.1 Payment processing

Following the decision of the CJEU, the Upper Tribunal has formally allowed HMRC's appeal against the FTT's decision in favour of National Exhibition Centre Ltd. As the Court ruled that the company's supplies of processing credit and debit card payments did not fall within art.135(1)(d) PVD, the basis of the company's case failed. Its supplies were all taxable.

Upper Tribunal: *HMRC v National Exhibition Centre Ltd*

DPAS is a company that provides services to dentists, including the collection of regular payments from customers by direct debit. Following the CJEU decision about DPAS's competitor Denplan in *AXA* (Case C-175/09), the company changed its arrangements so that the *AXA* decision would not apply to it: the CJEU had held that collecting direct debits for the dentists constituted "debt collection", and was therefore excluded from exemption under the terms of art.135(1)(d) PVD. Denplan changed its arrangements so that the processing service was provided to the customers, not to the dentists.

HMRC ruled that this was ineffective, putting forward a number of different reasons. The FTT rejected all of them, holding that the company had effectively implemented the new arrangements, and they were exempt. HMRC appealed to the UT, which came to a decision in November 2015 that was partly in HMRC's favour, and partly stood over behind *NEC* and *Bookit*:

- the UT agreed with the FTT that DPAS provided a service for consideration to the customers, where the customers had explicitly signed an agreement to that effect;
- the UT also agreed that this was a genuine arrangement and not an abuse of rights;
- however, the UT considered that there was no supply to the customers where they had not specifically agreed to the change of arrangements;
- the UT also held that a £10 registration fee was not an ancillary part of the supply of processing payments, so it was not exempt;

- the question of whether the processing service was exempt within art.135(1)(d) was held over behind *NEC* and *Bookit*, as was the question of whether it constituted debt collection within *AXA* even though it was supplied to the customers.

After the CJEU handed down its decisions in *NEC* and *Bookit* at the end of May, DPAS and HMRC made further submissions to the UT (Warren J and Judge Sinfield). The company argued that the CJEU in *AXA* had accepted that Denplan's services were within art.135(1)(d) and were only excluded from exemption because they were debt collection; as the FTT had decided as a fact that these services were not debt collection, these indistinguishable supplies must be exempt. HMRC responded that the services were covered by the same principles as the card processing services in *NEC* and *Bookit*.

The UT discussed the recent CJEU judgments and considered whether they determined the issues in the present case. The judges decided that they did not: it was impossible to say for sure what the CJEU would decide on the key issues, both as regards debt collection and the scope of art.135(1)(d). They therefore decided to refer questions to the CJEU, and invited submissions from the parties on how those questions should be phrased.

Upper Tribunal: *HMRC v DPAS Ltd*

2.3.2 Financial services (1)

A company owned and operated kiosks in supermarkets that would accept loose change from customers, count it, and return to them a cash voucher that could be used for shopping. It charged a 9.9% commission for the service, which it shared with the supermarket. HMRC originally ruled in 2000 that the commission was exempt where a voucher was issued to the customer, but an alternative involving arranging a donation to charity (with Gift Aid) was taxable. The transaction was considered to fall within Sch.9 Group 5 item 1: "The issue, transfer or receipt of, or any dealing with, money, any security for money or any note or order for the payment of money."

In 2015, following an inspection, the HMRC issued a new ruling that the commission was taxable. They cited case decisions as the reason for the change in ruling. The Tribunal noted that 31 decisions were included in the bundle. HMRC argued that the appellant was making an overarching taxable supply comprising two elements:

(1) Sorting and counting the coins accurately

(2) Issuing the customer with a voucher which can be redeemed for cash or goods in the supermarket in which the machine is located.

HMRC accepted that the voucher could be a security for money, but argued that that was insufficient in itself for the overall supply to come within the finance exemption in art.135 PVD and Sch.9 Group 5. The counting and sorting elements predominated.

The appellant argued that the service provided was one of exchanging coins for a more convenient, more usable means of exchange. The coin counting was a necessary prerequisite, but it was not the predominant element of the service.

The Tribunal agreed with the appellant on this point: the 9.9% commission seemed too high for a mere coin-counting service. The customer wanted a more convenient means of paying for goods in the supermarket. The Tribunal went on to consider whether this was exempt.

HMRC considered that the decision in *Wilton Park Ltd and others v HMRC* (about "Secrets money") supported their view. The vouchers in that case were agreed to be "securities for money" but dealings in them were not exempt. The Tribunal considered that the facts of that case were different, and this one was nearer the *Kingfisher* case, where such vouchers had been held to be exempt.

The Tribunal considered that the transaction was analogous to a foreign exchange conversion. Although the coins were in the same currency as the voucher, there was nothing in the PVD to restrict such transactions to those effected in different currencies. The various decisions cited by HMRC differed in that the underlying service was not a financial one. In *Wilton Park*, it had been held that the commission charged to the dancer for redeeming vouchers was part of the consideration for giving her access to the customers. It was not truly for dealing in vouchers. In *Ladbroke*, *Bookit* and *NEC*, there was an underlying non-financial service, such as bookmaking or acting as an agent for an entertainment venue.

The Tribunal was satisfied that the company's supplies fell within Item 1, and allowed the appeal.

First-Tier Tribunal (TC05346): *Coinstar Ltd*

2.3.3 Financial services (2)

Two companies made small, short-term loans to private individuals, often referred to as pay-day loans. The companies had accounted for output tax on reverse charge services purchased from abroad in 2010 to 2013, but subsequently decided those services were properly exempt and claimed the VAT back. They were not at the time, but were now, part of the same VAT group. Nothing turned on that.

The first type of supplies at issue was "lead generations" (referred to as "leadgens"). A potential borrower visited a lead generator's website and filled in an online form. The generator submitted this to a number of payday lenders, whose software would electronically and instantly decide whether to accept and pay for the lead. If the appellant did so, the applicant would see a page from the appellant's website offering the terms of a loan. This could be accepted by clicking a button and electronically signing loan documentation.

Judge Mosedale noted that the appellants only entered into contracts with lead generators on whom they had carried out satisfactory due diligence, which met the necessary regulatory conditions, and whose online application form asked a number of questions to which the appellant required answers. HMRC argued that the lead generators were simply selling leads to the highest bidder; the judge accepted that there was more than that, because the appellants monitored generators to make sure they provided relevant leads and asked those that did not gather the important information to update their systems.

Only about 1% of the applications referred by lead generators were offered loans. The most significant reason for rejection was that the

borrower was already known to the appellant. The company would not pay for a lead where it already had a relationship with the applicant, even if that relationship had terminated.

The second type of supply at issue was various supplies made by another company called Allsec. These included services in relation to dealing with customers. Before the hearing, HMRC accepted that two particular areas were exempt: where Allsec acted as an agent in agreeing a new loan for an existing customer, or in deferring repayment of an existing loan by agreeing a new replacement loan on different terms. There were still disputes about:

- conversions, where Allsec rang up potential customers who had been offered a loan but had not accepted it, with a view to completing the sale;
- live chat, which involved online interaction with people who had spent some time on the companies' websites without applying for a loan.

It was agreed between the parties, and accepted by the judge, that Allsec supplied a bundle of separate and separable supplies, rather than a single compound supply made up of indivisible parts. Each component should therefore be looked at separately, because it was capable of having a different liability to the rest.

Judge Mosedale noted that the exemption that could be relevant to all the supplies was for "negotiation of credit". She considered a number of precedent cases to establish the following principles:

- exemptions should be construed strictly, but not so as to deprive them of their effect;
- what matters is the nature of the supply and not the identity of the supplier;
- an intermediary can act entirely electronically;
- while the exemption has not changed, the services covered by it can evolve;
- an intermediary will be remunerated for intermediary services but will not be a party to the contract between the borrower and the lender;
- negotiation can be exempt even if no contract results;
- an intermediary does not have to undertake the entire mediation, and can be one of a chain of intermediaries;
- intermediation does not include carrying out back office functions or advertising, or acting as a mere conduit directing customers to a supplier with no other role in the transaction;
- an intermediary is someone who introduces two parties, one looking for a financial product and a person providing it; or is someone who negotiates the terms of such products as between the borrower and lender; or is someone who concludes a contract on behalf of one or other parties.

Of these potential issues, those that were relevant to the case were "entire mediation", "chain", and "advertising or mere conduit". These were the things that HMRC argued the lead generators did. HMRC's case was that:

(a) There was no legal relationship between borrower and leadgen;

(b) The lead is sold for to the highest bidder and there is no attempt by leadgen to obtain best deal for the borrower.

(c) There is no 'real' assessment of the potential lead, and the leadgen determines in a 'millisecond' whether the customer fits the appellant's (and other financial institutions') criteria;

(d) There is only a 1% chance that a lead offered to the appellant will be purchased by the appellant.

(e) The appellant duplicates the checks undertaken by the leadgen in any event.

(f) HMRC's case was that the economic reality is that the appellant undertakes a broad filter of potential loan customers, though which it is straightforward to pass;

(g) The appellant's criteria are not complex nor require exercise of any judgment or discretion by Leadgen.

The judge considered each of these in turn and rejected them all. In her view, the lead generators were acting in an intermediary capacity, and their supplies were properly exempt.

Turning to the Allsec supplies, the judge noted that these did not involve introduction by Allsec to the appellants. Allsec contacted people who were already visiting the appellants' websites. There was nothing within either the conversions or livechat supplies to constitute negotiation of credit, and the appeal was dismissed in respect of these aspects.

First-Tier Tribunal (TC05334): *Dollar Financial UK Ltd*

2.3.4 Welfare

A non-profit limited company provided day care services for adults with a broad spectrum of disabilities, principally learning problems. Its clients included those with severe autism, Down's syndrome, severe behavioural difficulties, learning disabilities, and Crohn's disease. The company provided its services under a formal care plan agreed with the social services department of Gloucestershire County Council, and was approved and registered to provide these services by the council. About 50% of the Appellant's services were supplied to individuals in residential homes, 25% were paid for by individuals or their carers out of the personal budgets paid to them by the council, and 25% were paid for directly by the local authority.

The issue before the Tribunal was whether the company qualified for exemption of its welfare services under Sch.9 Group 7 item 9 as a "state-regulated private welfare institution or agency". Note 8 provides that "state-regulated" means "approved, licensed, registered or exempted from registration by any Minister or other authority pursuant to a provision of a public general Act, other than a provision that is capable of being brought into effect at different times in relation to different local authority areas."

The company believed that it qualified because it was exempted from registration under the Health and Social Care Act 2008.

In the first of two hearings, the Tribunal concluded that this was not the case. The company was not subject to a requirement to be registered, which meant it could not be exempted from registration. The expression "exempt from registration" referred to certain bodies that fell within the Act but, owing to the specific services they provided, were specifically exempted from the requirement. This company fell within a class of entities that "may" be registered, but it was not required to be. This meant that the services were not exempt under VATA 1994.

The Tribunal then turned to the Directive, noting that art.132 has two provisions that refer to welfare:

(g) the supply of services and goods closely linked to welfare and social security work, including those supplied by old people's homes, by bodies governed by public law or by other bodies recognised by the Member States concerned as being devoted to social welfare;

(h) the supply of services and goods closely linked to the protection of children and young persons by bodies governed by public law or by other organisations recognised by the Member State concerned as being devoted to social welfare;

Art.133 permits member states to make the granting of exemption under certain paragraphs of art.132, which include para.(g), to bodies other than those governed by public law subject to one of four conditions (one of which is that the supplier be non profit making). Art.134 provides that a supply shall not be granted exemption within, among other paragraphs, (g) if it is not essential to the transaction exempted, or where the basic purpose of the supply is to obtain additional income through transactions in competition with commercial enterprises.

On this basis, the company advanced an argument that the UK law breached fiscal neutrality by exempting all welfare supplies provided by charities, but restricting identical welfare supplies provided by non-profit bodies such as the appellant.

The Tribunal noted that where the supply was made to the local authority, there would be no issue of fiscal neutrality, because the authority could claim the VAT back under s.33. This was the case even if the authority failed to do so, or failed to adjust the budget allocated to the company in order to allow for the recovery. The issue was with the other 75% of the company's supplies.

The Tribunal considered the CJEU precedents of *Kugler* (Case C-141/00), *Zimmerman* (Case C-174/11) and *Kingscrest* (Case C-498/03) in detail. The PVD had changed the wording of art.132 to extend it to "bodies devoted to social welfare", whereas the 6th Directive restricted it to "charities". The UK's wording in Note 9 breached fiscal neutrality in allowing exemption in this area to any charity, but not to a body such as the appellant company. The appeal was allowed.

First-Tier Tribunal (TC05197): *Life Services Ltd*

2.3.5 Professional body

An association sought repayment of VAT accounted for on its subscriptions on alternative bases:

- it was within Sch.9 Group 9 item 1(c) as "an association, the primary purpose of which is the advancement of a particular branch of knowledge, or the fostering of professional expertise, connected with the past or present professions or employments of its members";
- it was within Sch.9 Group 9 item 1(e) as "a body which has objects which are in the public domain and are of a political, religious, patriotic, philosophical, philanthropic or civic nature".

It appealed against HMRC decisions that neither provision applied, and the resulting refusal of the repayment.

The Tribunal reviewed the history of the body, its constitution and its aims as set out on its website, its membership and its activities. It noted that Item 1(c) is restricted by the legislation to associations which restrict their membership wholly or mainly to individuals whose present or previous professions or employments are directly connected with the purposes of the association. HMRC accepted that this was satisfied, but did not accept that:

- the fostering of expertise in graduate careers advisers was the fostering of professional expertise; or
- fostering the expertise of graduate careers advisers was the primary purpose of the association.

As regards Item 1(e), the Tribunal had to consider whether the association's objects were "in the public domain", and whether they were philanthropic or civic in nature. Two matters of general principle were also considered: the fact that exemptions should be strictly construed, and the need for an interpretation that made the domestic legislation conform to the purpose of the PVD. The Tribunal did not accept the appellant's argument that Parliament had intended Group 9 to be wider than art.132(1)(l) PVD – the more specific wording of Group 9 was an attempt to better describe what was in the PVD, rather than to widen it.

The Tribunal also rejected the appellant's view that careers advice is a "profession". There was no exhaustive definition; it was important to distinguish "a profession" from "an activity carried on in a professional manner". The most natural reading of the legislation required an existing recognised profession, which the association did not fall within. Although that was enough to rule out Item 1(c), the Tribunal also considered whether "fostering expertise" was the only or primary purpose of the association, and concluded that it was not.

Turning to Item 1(e), the Tribunal noted that the words "in the public domain" are not in the PVD. In the judge's view, the reference should simply be read as requiring the appropriate level of public interest in the pursuit of the objects that are listed in art.132(1)(l) and reflected in Group 9 Item 1.

"Philanthropy" required a broader benefit to people or society in general than the association provided. "Civic objects" also required a benefit to

wider society. The principal beneficiaries of the association's services were its members and the students who benefited from their services.

The appeals were dismissed.

First-Tier Tribunal (TC05309): *Association of Graduate Careers Advisory Services*

2.3.6 Direct effect of cultural exemption

The British Film Institute made a *Fleming* claim in respect of tickets to the National Film Theatre and some film festivals sold between 1990 and 1996. It had accounted for output tax, believing that it did not qualify for exemption under the cultural services provisions; but it subsequently realised that it should benefit from the *London Zoo* decision, as its main management was "essentially voluntary" in nature.

The Institute argued that from 1990, the UK was no longer entitled to tax cultural services which were covered by art.13A(1)(n) 6th Directive. A transitional provision which allowed taxation had expired, but the UK had not introduced the required amendments to Sch.9 VATA 1994. The Institute therefore claimed direct effect of the Directive in the absence of any domestic implementation of the provision.

When Group 13 was inserted into Sch.9 in 1996, supplies by cinemas were not included – even though they are envisaged in the Directive. There is therefore a further area of dispute between the Institute and HMRC concerning the availability of exemption after 1996 – now, the question is whether the UK is entitled to restrict the types of supply to which exemption applies.

The FTT (TC02490) considered a number of precedent cases, including several decisions of the VAT Tribunal which had supported HMRC's view that the UK was entitled to exclude cinema tickets from exemption because the Directive referred to "certain cultural services" (i.e. selected or restricted services, such selections or restrictions to be chosen by the member state). These decisions had been taken without reference to the CJEU decision in *Commission v Spain* (Case C-124/96), in which the Spanish government had argued a similar point in relation to the similar expression "certain services closely linked to sport". The Court had ruled that this did not entitle the state a wide discretion, but only related to the fact that such services had to be supplied by "the right sort of person".

The FTT concluded that the Directive was sufficiently clear and unequivocal to confer the benefit of direct effect on the Institute, and allowed the appeal.

HMRC appealed to the Upper Tribunal. It was accepted that admission to a cinema was capable of being a cultural service within the meaning of the Directive, and the BFI was a qualifying cultural body; the only question was whether, as the FTT held, the terms of Article 13A(1)(n) were (a) sufficiently clear and precise for it to have direct effect, and (b) not such as to permit the Member States any latitude or discretion in its application. The key question, therefore, was what was meant by "certain cultural services".

The Upper Tribunal considered the arguments again about the relevance of *Commission v Spain*, and also *Hoffmann* (Case C-144/00) which

concerned the scope of the cultural services exemption; and *Canterbury Hockey Club* (Case C-253/07) and *Mesto Zamberk* (Case C-18/12), which examined the exemption for sport, which uses the same expression – "certain services closely linked to sport". The judges accepted that the word was capable of confusing the issue, but concluded that the CJEU precedents were clear that it did not allow Member States a wide discretion to limit the scope of the sporting exemption. It could not mean one thing in relation to cultural services and a different thing in the next sub-paragraph in relation to sporting services. Its effect was to restrict the exemption to those services mentioned in Annex H as cultural services eligible for the lower rate, when supplied by the right kind of organisation.

HMRC's appeal was dismissed again by the UT, but the CA decided to refer questions to the CJEU. Advocate-General Bot has now given an opinion in the case. The A-G is in no doubt that use of the word "certain" (as opposed to "all") means that the legislature intended for Member States to be able to choose which supplies of cultural services should be exempt. Initially, it was proposed to draw up an exhaustive list of the supplies of cultural services subject to VAT exemption. That exemption related specifically to the supply of services by theatres, cinema clubs, concert halls, museums, libraries, public parks, botanical or zoological gardens, educational exhibitions, and operations within the framework of activities in the public interest of a social, cultural or educational nature. This list was not adopted in the Directive. There has been discussion in Commission reports on the operation of the Directive that this imprecision is not desirable, but Member States have resisted any change that would create a mandatory exemption.

The A-G suggested that "the exercise of the Member States' broad discretion is necessarily shaped by the objectives pursued by the Sixth Directive and the principles governing VAT." The objectives of the exemptions in art.13A(1)(h) to (p) must be "in the public interest", and Member States should only exempt such services in line with the principle of fiscal neutrality – if exemption would create distortion of competition, it should not be granted.

The A-G therefore stated that it was for the referring court to decide whether it would infringe fiscal neutrality to exclude the BFI from exemption. He specified as a comparison point "the supply, by public bodies or eligible bodies, of a right of admission to a theatrical, musical or choreographic performance of a cultural nature", rather than "the supply of cinematic performances by commercial operators".

The A-G then turned to the CA's first question, which was whether the provision had direct effect in the absence of any UK legislation on the subject. In his view, it did not, and therefore could not be relied on by a taxpayer in an action against the state. This was because the Directive did not give any indication of the nature of the cultural services that were to be covered by the exemption. It would have been different if the Directive had provided a definitive list of cultural services, but it contained no list at all. It therefore appears that the BFI will lose its refund claim.

CJEU (A-G) (Case C-592/15): *HMRC v British Film Institute*

2.4 Zero-rating

2.4.1 Caravan kits

A trader supplied packs of timber pieces that could be used to construct a wooden cabin. It was agreed between the parties that the supply combined with installation by the supplier created something that qualified as a "caravan" for the purposes of VATA 1994 Sch.8 Group 9 and could be zero-rated. HMRC ruled that the supply of the pack in kit form, for assembly by the customer, was standard rated.

The appellant cited some old purchase tax cases in support of the contention that the supply of a kit for a specific purpose should be taxed in the same way as the finished item, and should be distinguished from the supply of parts for general purposes.

Group 9 refers to caravans that have been "manufactured" to certain standards. The FTT was invited to consider whether this could refer to the manufacture of the parts, or had to refer to the construction of the caravan itself out of those parts. The judge examined non-VAT law (the Caravan Sites and Control of Development Act 1960) for a definition of a caravan, and concluded that it had to be a "structure". The unassembled parts were not, at the time of supply, a caravan.

On the other hand, the judge accepted that the trader supplied a kit to make a caravan, which was not the same as a general supply of building materials. In some cases, HMRC accepted that a kit could be given the same VAT treatment as the finished item (e.g. a kit to make children's clothes, which is zero-rated even though cloth is standard rated). The judge referred to the purchase tax precedent of *Betterways Panels Ltd v Commissioners of Customs and Excise* and the VAT Tribunal decision in *Cheshire Mushroom Farm* (1974) which seemed to follow the same principle, and concluded that the kit should be given the same treatment as the finished item. The appeal against an assessment was allowed, because the kits should be zero-rated.

First-Tier Tribunal (TC05312): *Scandinavian Log Cabins Direct Ltd*

2.4.2 Sanitary protection

Clause 125 of the Finance Bill was amended to provide that the commencement date for zero-rating of women's sanitary products must not be after the later of 1 April 2017 and the earliest date that may be appointed consistently with the UK's EU obligations.

FB 2016 amendment 161; FA 2016 s.125

2.5 Lower rate

Nothing to report.

2.6 *Computational matters*

2.6.1 Calculations

A company appealed against an assessment for £460,630 to reverse an adjustment it had made to its output tax for the period ending 12/12. The appeal was a lead case for two other taxpayers with similar issues. The issue related to the calculation of participation fees for bingo. HMRC had published a Brief (07/07) which suggested that the correct approach was to calculate the participation fees on a "session by session" basis rather than "game by game". The companies believed that their adjustment reflected this approach, and entitled them to make an adjustment under reg.38 SI 1995/2518 because there had been a "decrease in consideration for a supply, which includes an amount of VAT".

Customers pay a fixed sum to participate in a session of bingo which entails the right to play in several separate games of bingo, each of which offers a cash prize. For the purposes of VAT, this sum is divided into a stake and a participation fee. The stake is the element of the sum which is paid by the customer that is used to fund the prize for the winner. It is not consideration for any supply.

The company had historically accounted for output tax on participation fees on a game basis, in accordance with HMRC's published guidance at the relevant time. HMRC's Brief 07/07 indicated that it should have been accounted for on a session basis. The effect of the Brief and the session basis allowed the company to reduce the value of the participation fees (on which VAT was payable) where the participation fees for games within the session were added to the stake money (which was outside the scope of VAT) received from customers to guarantee a certain level of prize or to create additional prize money for other games within the session.

The company argued that a change in calculation of the apportionment between stake and participation fee resulted in a change in the amount of consideration for the supply – if the participation fee had gone down, then more of what the customer paid was stake money; that meant that the consideration for the VATable supply had reduced, and reg.38 was engaged. The company issued an internal credit note to adjust the VAT.

HMRC argued that the amount paid by the customer had not changed, so any claim had to be made under s.80 VATA 1994, and it would therefore be out of time. In HMRC's view, the apportionment between stake and fee must be known by the end of the session; it was therefore not possible for there to be an adjustment to consideration after the end of the relevant period, which is what reg.38 requires.

The Tribunal noted that a similar issue had been decided in the taxpayer's favour in the case of *Carlton Clubs plc* (TC01389). HMRC had not appealed that decision, but argued that it was not binding and had been wrongly decided. In their view, the company had made a mistake in its earlier periods (albeit because it had followed HMRC's policy), and could only correct it by making a s.80 claim.

The decision considers the detailed arguments of the taxpayer about the relationship between the valuation provisions which deem part of a mixed payment to be consideration for a supply, and HMRC's response that

art.90 PVD and reg.38 require an "event between customer and supplier" subsequent to the original supply.

The judge (W Ruthven Gemmell) explained in considerable detail why he preferred the company's arguments. He did not agree that art.90 required a repayment to the customer; reg.38 provided for "adjustments in the course of business", which covered this situation. The appeal was allowed.

First-Tier Tribunal (TC05257): *K E Entertainments Ltd*

2.7 Discounts, rebates and gifts

Nothing to report.

2.8 Compound and multiple

2.8.1 Healthcare and prostheses

215 different providers of healthcare made *Fleming* claims for input tax incurred before 1987, relying on the Court of Appeal's 1997 decision in *Wellington Private Hospital* that certain drugs and prostheses could be regarded as zero-rated supplies separate from the exempt supply of healthcare. In the designated lead case TC02697 (*Nuffield Health*), the FTT concluded that there was a single exempt supply.

One of the other claimants applied not to be bound by the lead decision. This application was dismissed by the FTT, and the company appealed to the UT. It argued that the FTT had made errors of law and its decision should be overturned. HMRC maintained that the FTT had come to the correct decision for the correct reasons. This departed from the Court of Appeal's reasoning in 1997 because of a considerable amount of CJEU case law since then, including *CPP*, *Levob*, *Deutsche Bank*, and *Field Fisher Waterhouse*. The House of Lords had also given relevant judgments in *Beynon* and in *College of Estate Management*.

The UT examined several of the precedents, including the *Wellington* decision itself. The judge was satisfied that the FTT had been correct to regard the reasoning in *Wellington* to be flawed: Millett LJ had considered that there must be a principal/ancillary relationship between the elements of a supply for them to be regarded as an indivisible whole, whereas *Levob* showed that this was only one factor to take into account.

The taxpayer's counsel argued that the patient was more likely to regard the prosthesis as closely associated with the supply by the consultant, who was usually a self-employed person. This was advanced as a reason for the prosthesis not being closely associated with the supply by the hospital, following *Telewest* (supplies by different people cannot be compounded). The UT did not agree. The *Levob* question should be determined by the customer's view of what the hospital supplied, and the involvement of a different supplier would not necessarily change that.

The key question here was not whether the supply of the prosthesis was "ancillary to" the supply of healthcare or "a means of better enjoying" it. The UT considered rather that the two were clearly so closely linked that

they form, objectively, a single, indivisible economic supply which it would be artificial to split. If the consultant had supplied the prosthesis, there would be a single supply of "healthcare plus prosthesis" by the consultant; even though the consultant provided an important element of the healthcare, the typical patient would still regard the supply received from the hospital as "healthcare including prosthesis".

The appeal was dismissed.

Upper Tribunal: *General Healthcare Group v HMRC*

2.9 Agency

2.9.1 Staff hire concession

In 2015, the Upper Tribunal heard an application for judicial review of HMRC's decision not to allow a company the benefit of a concession set out in Business Brief 10/04. This was the permission for an employment bureau to account for VAT only on the commission element of its charges, by choosing to be treated as an agent arranging a transaction between a work-seeker and the client. This was intended as a temporary concession while HMRC reviewed the impact of the Conduct of Employment Agencies and Employment Business Regulations 2003, which in their view would change the legal relationships between agencies, work-seekers and their clients, and would eventually lead to the withdrawal of the staff hire concession.

HMRC directed the company to account for output tax on the whole of its charges between March 2007 and March 2008. The company's application for judicial review was based on two alternative arguments:

- first, that the supplies fell within the terms of the concession in BB 10/04, and HMRC had misinterpreted their own concession and misapplied it to the facts; or
- HMRC had failed to apply the law correctly and had misdirected the company to treat its supplies as supplies of education rather than giving it the option to be treated as an agent arranging supplies of staff.

The company had been in the business of supplying lecturers to colleges of further education. To start with it treated them as exempt, but HMRC wrote to the company in December 2005 to rule that it did not qualify as an "eligible body" in respect of educational supplies. Although the company itself was limited by guarantee and non-profit making, its surplus income was stripped out by means of intra-group charges to commercial companies, so it should not be regarded as eligible.

After this, the group restructured its operations, setting up a new company to act as an employment bureau. Many of the colleges agreed to transfer their supplies to this company. Where colleges did not agree to such a transfer (for a variety of reasons "including simple apathy"), the former company (ELS) continued to treat them as exempt education. The new employment bureau (PNL) treated its supplies as within BB 10/04.

HMRC were not satisfied, and negotiations continued to establish the correct VAT liability. Meanwhile, the CJEU issued its judgment in *Horizon College* (Case C-434/05) on 14 June 2007. This meant that the company could not be supplying "education", but only "supplies closely connected with education"; the grounds for treating "closely connected" as exempt required the supply of education to be made by the same person, e.g. catering in a university canteen. At a further meeting in September 2007, ELS maintained that it exercised control over the lecturers; the UT judge noted that this meant HMRC could not at this point have appreciated that the company was supplying staff rather than education.

This point was made by PNL in a letter to HMRC in December 2007; HMRC eventually accepted that PNL was supplying staff and was eligible to use BB 10/04, not only going forward but retrospectively. However, it was not clear to HMRC that ELS was also supplying staff. Further information was sought in early 2008 by meetings, correspondence and visits to colleges. Eventually, in July 2009 HMRC accepted that ELS's supplies were "more likely to be of staff than anything else", but they did not accept that BB 10/04 could be applied. This was confirmed in a letter of 14 December 2009: the reason was that the company did not do anything to indicate, at any time, to its customers that it was acting, or intended to act, as an agent. This position was maintained in spite of further information and submissions, up to a final ruling in December 2012, which was the subject of the application for judicial review.

The UT judge (Mrs Justice Proudman) examined the history of events and decided that the evidence suggested that ELS had not made an early choice to be treated as supplying staff, and had not complied with the invoicing conditions of BB 10/04. It seemed more likely that the company still regarded itself as supplying education as a principal. The invoices were not determinative of the question, but they provided some evidence of what the company thought it was supplying and what choices it had made: it charged a single VAT-exempt amount.

In the second part of the argument, the company maintained that HMRC had misdirected it in 2005. Had they been given clearer guidance at that time, they would have been able to change their arrangements to take advantage of BB 10/04. Once again, the judge examined the evidence and concluded that any misunderstanding on HMRC's part arose from a lack of clarity in the disclosure of facts by the company. Until a number of issues were corrected by a letter of 26 November 2008, the company had consistently told HMRC that it was acting as principal. The company had therefore not "placed all its cards face upwards on the table", and could therefore not insist on the fair treatment it might have enjoyed had it done so. The application for judicial review was dismissed.

The company appealed to the Court of Appeal. The Court noted that an extra-statutory concession should not be given too great a scope, because it represented a decision by HMRC not to collect tax that was due according to the statute. There was nothing in the wording of the concession that suggested a decision to be taxed as an agent could be taken retrospectively, and ELS had not chosen to be taxed as an agent at the relevant time. The application was refused again.

Court of Appeal: *The Queen (oao ELS Group Ltd) v HMRC*

2.9.2 Agency – taxis

HMRC issued a decision to register an individual with effect from 1 April 2009, together with an assessment to VAT for £77,000 and a s.67 penalty for failing to register. The key question was familiar from other cases about taxis: was his firm supplying transportation as principal, in which case the whole fare was his taxable turnover, or was his firm supplying services to drivers, in which case only the amount he charged to the drivers was relevant to his VAT registration liability?

The trader had himself been a taxi driver but had taken over the business in 2008. He took over some account business, which the Tribunal found involved contracts between the account customers and the taxi firm. Strangely, the trader remitted 100% of these fares to the drivers: he said that this was to attract drivers to his firm in a small town with a competitive market for taxis. The Tribunal accepted that this was a fact.

The Tribunal judge considered various precedents, only one of which was of binding authority. He agreed that it was crucial to decide who made the supply of transportation to the contract customers: "was it the appellant, acting as principal i.e. on his own behalf, or was it the drivers for whom the appellant was their agent in arranging the jobs?"

It was accepted by HMRC that the appellant was only acting as an agent in relation to cash fares. The judge considered that this imposed a burden on HMRC to show that there was a difference in the arrangements between the cash fares and the account business.

HMRC argued that three features of the arrangements demonstrated this difference: negotiation by the appellant, invoicing by the appellant and receipt of payment in his business account. The judge did not "accept this for a moment". He considered these to be necessary practical features of the account business, but not determinant of the contracts. He examined the precedents and the facts, and concluded that the trader was acting as an agent throughout. HMRC's decision to register was therefore incorrect, and the appeal was allowed.

The judge went on to comment on the surprising lack of use of art.28 PVD and VATA 1994 s.47 by HMRC's counsel. Those provisions appeared to suggest that it was open to the Commissioners to regard services invoiced in the agent's own name as bought and sold as principal, regardless of the contractual position. It was not clear to the judge why HMRC had not used it during the enquiry as a "knock-out blow", or why they did not use it in argument before him. Nevertheless, they had not, and as a result it did not affect the decision.

First-Tier Tribunal (TC05358): *Khalid Mahmood*

2.9.3 Updated Notice

HMRC have updated their Notice *Taxis and private hire cars*, which sets out the basics of the VAT treatment of both drivers and taxi operators. Given the complexities of this business, as illustrated by the above case, it is a fairly sketchy document.

Notice 700/25

2.10 Second hand goods

Nothing to report.

2.11 Charities and clubs

2.11.1 Business

HMRC have won the *Longridge* case in the Court of Appeal.

Background

A charity had as its object "the advancement of education in water, outdoor and indoor activities for young people generally". It engaged a builder to construct a new training centre on land it owned by the River Thames. HMRC ruled that the construction was standard rated. The charity appealed, arguing that the building would be used for a relevant charitable purpose. The VAT at issue was over £135,000.

HMRC's view was that the charity carried on a business, in that it charged participants for courses. The charity argued by contrast that the centre was fundamental to the fulfilment of its charitable objects, and the courses were heavily subsidised by donation income. Viewed in context, the consideration charged for the courses was not enough to make the activity a "business".

First-Tier Tribunal

The FTT (TC02574) examined the facts in detail, including the financial information available on the costs and revenues from various activities. In many cases, courses were deliberately provided at a loss, in accordance with the charitable objects. In other cases, a surplus arose, for example on "corporate days". A schedule was provided to show the use of the disputed building. Over a period of 18 months, some 5,800 people used it, of whom just over 4% were "corporate teams".

The appellant argued that it did not satisfy the criteria of a "business" according to the *Lord Fisher* tests. Even if part of its activities were a business, the business use of the building was below the 5% de minimis test. The precedent cases of *Yarburgh Children's Trust* and *St Paul's Community Project* should be applied.

HMRC argued that the onus was on the appellant to show that it was not carrying on a business, given that it was providing services for a consideration. The VAT Directive stated that a business existed regardless of the purpose or results of the activity; and there was an implication, in the list of exemptions for charitable activities in art.132, that charities were within the scope of VAT where they provided services for consideration that were not exempt.

HMRC's counsel had the following to say about *Yarburgh* and *St Paul's*:

In the Commissioners' submission the Appellant cannot rely on the Yarburgh and St Paul's Community Project cases, where the facts were quite different, with cooperative ventures run by beneficiaries (and in the St Paul's Community Project case, the nursery undertaken for the social

reasons of providing nursery education for disadvantaged and difficult children). Those cases (in the High Court) are concerned only with whether the tribunal could reasonably reach the conclusion that it did on the facts, and to the extent that they decide that a charity is not carrying on a business if its predominant concern in carrying on a particular activity is to pursue its charitable purposes, then they are wrongly decided: the question is whether the activities objectively are of a business nature, regardless of the purpose for which they are undertaken. In neither of those cases was the court directed to Articles 132 and 133 of the Directive.

The FTT was more willing to follow the reasoning of the judges in those cases. The reasoning of both was examined, and the *Lord Fisher* tests were applied to the current case. This was the conclusion:

Expressing the point by reference to the Lord Fisher case indicia, it is the case that the Appellant's activity is a serious undertaking earnestly pursued with reasonable continuity; and that the enterprise is substantial in size and value, and the supplies it makes (or something similar) are made by commercial enterprises; and that it adopts and applies prudent financial management. However, there are features of its activities which are not consistent with sound business principles (most obviously its use and reliance upon volunteers and its reliance upon donations to meet part of its operational costs and to meet all its capital costs); and its predominant concern is not to make taxable supplies to consumers for a consideration, but to carry out its activities in a manner which furthers its charitable objectives. The making of supplies for a consideration is incidental to its predominant concern of furthering its charitable objectives in that it is one means (admittedly an important one) by which its predominant concern is achieved.

After deciding that the overall activity of the charity was not the carrying on of a business, the Tribunal further considered the use of the building. Although the use of the upstairs for various activities which were not within the charitable objects made the question less straightforward, the Tribunal was satisfied that the overall use was for charitable purposes. The appeal was therefore allowed.

Upper Tribunal

HMRC appealed to the Upper Tribunal. Counsel for the taxpayer argued that the FTT's decision was one of fact which the UT should not overturn; HMRC's counsel argued that the error of law lay in focussing on the pricing (and loss-making) as indicative of non-business activity, when it had been recently confirmed by the CJEU in the *Finland* case (Case C-246/08) that an activity does not have to be profit-making to be "economic activity" for VAT purposes. He also argued that *Finland* showed that the *Yarburgh* and *St. Paul's* decisions were suspect.

The judge did not regard *Finland* as supporting a general principle that analysis of prices charged was wholly irrelevant to the question of whether a business was carried on. It appeared that the FTT had considered the facts of the case and had understood that it was making a decision as to which side of a line this entity fell on the basis of those facts; this was something the FTT was entitled to do.

The judge also rejected HMRC's argument that the existence of exemptions for various charitable activities in the PVD necessarily implies that such activities are always economic (if they were not, an exemption would not be required). It was proper to ask first if there was an economic activity; it was possible for something to fall below the threshold that would make it so, in which case exemption would be irrelevant, or to go over the threshold, in which case the application of the exemption would be a separate question.

The judge held that the FTT had applied the correct test, and there were no grounds for disturbing its conclusion.

Court of Appeal

Lady Justice Arden gave the leading judgment, with which Tomlinson LJ and Morgan J agreed. She summarised HMRC's case as follows:

The nub of HMRC's case is that this approach is not consistent with EU law. HMRC contend that the [CJEU] has recently clarified the test for determining whether there is an economic activity and that this now focuses on whether there is a direct link between the service which the recipient receives and the payment which he makes, not on the wider context in which the payment was made. If the direct link is not present, there is no economic activity.

The judge sets out the submissions of the respective counsel in some detail. HMRC argued that the concept of economic activity is wide in scope and objective in nature; the taxpayer responded that the context of the activity has to be considered, and a comparison has to be drawn between the present situation and ordinary market behaviour. The PVD requires a charge where there is a "taxable person acting as such", which suggests that supplies can be made for a consideration but not in the context of economic activity.

The precedents were divided between European and domestic cases. The CJEU has held that the concept of economic activity is objective; a profit, or even a profit motive, is not required. An activity is in general categorised as economic where it is permanent and is carried out in return for remuneration received by the person carrying out the activity. The activity must be carried out in return for remuneration and there must be a direct link between the service and the money received by the service-provider.

Lady Arden considered whether the domestic precedents – in particular *Morrison's Academy*, *Lord Fisher*, *Yarburgh* and *St Paul's* – were consistent with the EU case law. In her judgment, these cases have diverged from the proper test. "The Fisher criteria direct attention to (a) seriousness of the enterprise (b) the regularity of the activity (c) the substantiality of the activity (d) the organisational features or the enterprise (e) the predominant concern of the activity and (f) a comparison with commercial providers of the same service. These factors may have a role to play but they cannot displace the approach required by CJEU jurisprudence."

For this reason, the judge considered that the FTT had erred in considering the use of volunteers as relevant or significant in determining whether the charity was carrying on economic activity. The "predominant concern" test was also given too much weight: the test should be

objective, which means that the charity's intentions are not enough to convert what would otherwise be economic activity into an activity of a different kind for VAT purposes. This was enough to allow HMRC's appeal against the decisions below.

Lady Arden also made three further points:

- HMRC had argued that fiscal neutrality was relevant in considering whether the charity's activities were economic. The CJEU has held that the question of economic activity is prior to any consideration of fiscal neutrality, so this issue was not considered.
- HMRC also relied on the existence of articles 132 and 133 to show that activities of charities were essentially economic, because otherwise they would not need to be exempt. Again, the issue was not considered in detail, because the conclusion did not require it.
- Thirdly, it was not necessary to make a reference to the CJEU, because the existing case law enabled the court to make a decision.

Morgan J added some detailed reasons of his own. He summarised his conclusions as follows:

i) Longridge supplies services for consideration;

ii) Longridge's supplies are "permanent" as part of an established activity, regularly carried on;

iii) There is a direct link between the supplies and the consideration;

iv) The supply of services for consideration on a permanent basis is presumed to be an economic activity;

v) Even if Longridge's motive in supplying the services is more concerned with the benefit of the services to those to whom they are supplied, rather than obtaining the consideration for the services, any such motive would not alter the objective character of the supply;

vi) It is irrelevant in this case that the consideration for the supply of services is below the market value of the supply and, in some cases, involves a concession;

vii) There is no factor (or combination of factors) which rebuts the presumption that Longridge's supply of services is an economic activity; the facts that Longridge is a charity and its activities are non-profit making are not of any significance for this purpose;

viii) In all the circumstances, the supply of services by Longridge for consideration is an economic activity;

ix) Accordingly, Longridge does not satisfy Note (6) to Items 2 and 4 in Schedule 8 to VATA 1994 and the construction works in this case were not zero-rated.

The FTT had erred in law in taking into account (1) Longridge's motive in providing the services; (2) the fact that the consideration for the services was at a concessionary rate; and (3) the fact that Longridge was non-profit making.

Court of Appeal: *Longridge on the Thames v HMRC*

2.12 Other supply problems

2.12.1 Distortion of competition

The National Roads Authority is the Irish body responsible for the construction and management of national roads. It is a body governed by public law, and as such is generally regarded as not a taxable person under art.13(1) PVD. However, where a body governed by public law makes supplies for a consideration, and treating those supplies as not made in the course of economic activity would lead to a significant distortion of competition, the exclusion in art.13 does not apply.

The NRA collects tolls on some roads, and regulates private operators who collect tolls on other roads in accordance with Irish statutory provisions. The Irish courts referred questions to the CJEU to clarify whether treating the NRA as outside the scope of VAT would lead to significant distortions of competition, given that it was not likely that there would be any direct competition between one road and another, or a private operator entering into competition with one of the NRA's roads. The question arose in relation to a repayment claim by the NRA, which has traditionally charged VAT on the tolls it has received.

A-G Szpunar has given an opinion that this would lead to significant distortion of competition. The opinion starts with the comment that a major reason for not levying VAT on public bodies is that the money belongs to the government anyway – charging VAT leads to a movement of funds from one account to another, but there is no additional money raised for a significant administrative complication. However, the principle of universality of VAT makes for a presumption that everything should be charged and exceptions should be limited; and the principle of prevention of distortion of competition should apply where activities are carried on by public bodies on the same basis as they are or may be carried on by private bodies.

The A-G considered that the precedent case law did not establish that road tolls collected by a public authority are always collected in that capacity. It was possible that the "public authority" activity of the NRA was restricted to deciding to levy tolls on a particular road and setting the bye-laws for those tolls, but in collecting the tolls, it was acting in the same way as any private operator who might also be subject to those bye-laws. The A-G invited the referring court to reconsider its assumption that the NRA was acting in its public law capacity, because if that was wrong, the point of the question fell away.

Turning to the questions referred, the A-G considered that, where the same activity was carried on by public and private operators in the same state, there should be a presumption that distortion of competition would occur. The decision should be taken based on a consideration of the activity itself, rather than the circumstances of the particular market. To do otherwise would make VAT dependent on local conditions, which would offend against the principle of legal certainty.

The A-G reconciled the apparent anomaly between the need for there to be a real possibility of competition rather than a merely hypothetical one, and the need to consider the activity itself rather than the particular market-place. If there is no possibility of private operators engaging in

the activity, there is no risk of distortion of competition. For example, in Germany tolls are only collected by a public body. Where private operators are commonly involved in the activity, as in Ireland, there is a risk of distortion that is not merely hypothetical, even if there cannot be competition in relation to an individual road.

The questions referred also asked how to determine whether there was a significant distortion, if there was not an absolute rule that public bodies making supplies would be taxable. The A-G said, "*The determination of whether the distortions of competition in a specific case are more than negligible is a finding of fact which obviously falls to the national authorities and national courts. I would simply point out that a finding that distortions of competition are negligible does not call into question the presumption that such distortions exist, but simply allows tax not to be levied on the activities of a public body despite those distortions.*"

CJEU (A-G) (Case C-344/15): *National Roads Authority v HMRC*

2.12.2 Local authority recycling

The Upper Tribunal, acting as a judicial review body, has had to consider a preliminary question in relation to the activities of local authorities. The question for determination was:

Where a local authority ("LA") that is a Waste Collection Authority ["WCA"] for the purposes of the Environmental Protection Act 1990 ["EPA1990"] is making supplies of trade waste collection services to business customers (i.e. entities occupying non-residential property) in its area, are those supplies by the LA "activities in which it is engaged as a public authority" within the meaning of s.41A(1) VATA 1994 and/or art.13(1) PVD?

The applicant was a commercial business carrying out certain trade waste collection services. It found itself increasingly in competition with local authority waste collection; it had to charge VAT to its customers, not all of whom could reclaim it, and it considered that it was suffering unfair competition as a result. Its first line of attack was to argue that a LA engaged in waste collection was not acting "as a public authority", and it was therefore obliged to charge VAT, regardless of whether there was distortion of competition.

The judge (Warren J) considered CJEU precedents including *Fazenda Publica* and *Isle of Wight Council*. The *Saudacor* and *Finland* cases confirmed that treatment as non-taxable required the person carrying on the activity to be a body governed by public law, and the activity must be carried out in the capacity of a public authority.

The judge went on to consider the legal basis of local authorities' waste collection activities in great detail, and concluded that it was impossible to make a general statement that local authorities were not acting under a special legal regime (the EPA). It might be the case that an individual local authority was acting as a commercial operator rather than a public authority, but that would require detailed investigation of the particular facts. The preliminary issue was therefore decided against the applicant and in favour of HMRC and HM Treasury, who want to maintain the non-VATable status of local authority waste collection.

The judge commented that the applicant would have to pursue one of two alternative lines to succeed in forcing the local authority to charge VAT: one would be to establish that the "competition proviso" applied, which would have to be tested as a matter between the company and the local authorities in whose area it operates; the other would be to show that there are local authorities who are operating beyond their legal powers and cannot rely on s.45(1)(b) of the EPA 1990 as the "special legal regime" under which they are operating.

Upper Tribunal: *R (oao The Durham Company Ltd (t/a Max Recycle)) v HMRC and another*

2.12.3 Goods or services?

The questions for reference in the *Mercedes-Benz* case have been published. They seek guidance from the CJEU on how to tell the difference between hire purchase (a supply of goods) and leasing (a supply of services) by reference to art.14 PVD.

1. *What is the meaning of the words "a contract...which provides that in the normal course of events ownership is to pass at the latest upon payment of the final instalment" in Article 14.2(b)?*
2. *In particular, in the context of the present case, does the phrase "in the normal course of events" require a tax authority to do no more than to identify the existence of an option to purchase which can be exercised no later than upon payment of the final instalment?*
3. *Alternatively, does the phrase "in the normal course of events" require the national authority to go further and to determine the economic purpose of the contract?*
4. *If the answer to (3) is yes:*

   a. Should the interpretation of Article 14.2 be influenced by an analysis of whether the customer is likely to exercise such an option?

   b. Is the size of the price payable on exercise of the option to purchase relevant for the purposes of determining the economic purpose of the contract?

CJEU (Reference) (Case C-164/16): *HMRC v Mercedes Benz Financial Services UK Ltd*

2.12.4 Toolkit

HMRC have updated their "output tax toolkit". This is intended for use by tax agents and advisers in preparing returns for clients, and also in reviewing their clients' systems for preparation of VAT returns to identify risks and help mitigate them. It is likely to be too detailed for practical use by most tax agents, but does represent an excellent training tool for understanding the preparation of returns and what can go wrong. These are likely to inform visiting officers who will look for the most common errors in carrying out a routine compliance check (i.e. if they have not already identified some specific issue that they are following up).

Common output tax errors include:

- manual, arithmetical and consolidation errors
- omitted or duplicated invoices
- sales invoices posted gross without extracting output tax on standard or reduced rate supplies
- output tax incorrectly calculated on VAT-inclusive amounts or on supplies subject to a settlement discount
- incorrect VAT liability codes being set within a computerised accounting system
- VAT and net values transposed
- sales credit notes incorrectly posted.

Examples of supplies that can be overlooked include:

- cash sales
- sales of scrap
- incentive payments received from suppliers for meeting purchase or sales targets
- property income
- management charges
- commissions for agency sales
- charges to sub-contractors for use of vans or tools
- supplies to staff - invoiced or by payroll deduction
- mandatory restaurant service charges (although tips and optional service charges are outside the scope of VAT if freely given)
- payphone and vending machine receipts
- recharges of costs to third parties
- disposals of assets used in the business
- barter transactions
- receipt of reverse charge services
- receipt of goods subject to acquisition tax.

HMRC Toolkit: VAT Output Tax (2016)

3. LAND AND PROPERTY

3.1 Exemption

3.1.1 Land or construction services?

A company (F) was responsible for the construction of lodges and infrastructure at a holiday development attached to a golf course in Norfolk. A separate company owned the freehold of the land. A Swedish company supplied kits which were erected by F using subcontractors and employed carpenters. The issue was whether F was making zero-rated supplies of construction services, or a composite supply that did not qualify for zero-rating.

For the first three plots, the freehold title was transferred to F which subsequently granted a lease to a customer. For later sites, a different arrangement applied. The freeholder granted the lease to the customer, who entered into a separate agreement with F. The FTT had to consider the effect and nature of this agreement in detail. The company's solicitors had drawn it up by amending the previous version, so it used expressions such as "buyer" and "seller" even though they were not apparently strictly appropriate.

The company argued that its part of the deal was simply an agreement with the customer to construct a building designed as a dwelling. HMRC argued that it also contracted to procure the grant of the lease by the freeholder. In 11 of 15 examples, the lease and the agreement were signed on the same day, but it was not possible to know which happened first. In the other four cases the agreement was signed first; one customer's lawyer had refused to sign the lease first (so the deal fell through), on the grounds that he did not think his client should agree to lease the bare land without a binding assurance that something would be built on it.

The FTT reviewed various precedents and authorities on interpretation of contracts. The written contracts were the starting point for deciding what their effect would be; they would only be disregarded if they were a sham. When interpreting an agreement, the court must have regard to the words used, to the provisions of the agreement as whole, to the surrounding circumstances in so far as they were known to both parties, and to commercial common sense. When deciding on the categorisation of a relationship governed by a written agreement, the label or labels which the parties have used to describe their relationship cannot be conclusive, and may often be of little weight. The court will consider the rights and obligations of the parties as a matter of construction of the written agreement, and will then consider whether those obligations fall within the appropriate legal description (in this case, a zero-rated supply).

The FTT noted that the terms of the contract included F to provide a customer with proof of title to the property and proof of its ability "to procure its transfer", and the customer was entitled to issue "a notice to complete" requiring F to ensure the grant of a lease by the landowner. This went beyond the successful separation of the lease and the construction contract in *Lower Mill Estate*. F was making a composite supply, and it was therefore standard rated.

The company appealed to the Upper Tribunal. The judges (Sinfield and Waters) considered the contracts in some detail and the respective arguments about how they should be construed. The FTT had been correct to incorporate the Standard Terms and Conditions of Sale into the agreement in construing it. It was necessary to consider the surrounding circumstances: the most significant of these was that the customer agreed at one and the same time to buy a built lodge from Fairway and to take the relative lease from the landowner. The agreement said that the purchaser would be given vacant possession on completion; this could only be granted by the landowner, who was not a party to the agreement; the implication was that Fairway undertook to procure the grant of the lease.

The company had identified no error of law in the FTT's decision, and its appeal was dismissed.

Upper Tribunal: *Fairway Lakes Ltd v HMRC*

3.1.2 Immovable property?

A company supplied modular temporary classroom accommodation. HMRC ruled that it was making exempt supplies of land – immovable property – and therefore could not recover input tax on its costs. The Tribunal considered the *Maierhofer* precedent (Case C-315/00) in which the CJEU had ruled that the difficulty of putting up, taking down and moving a prefabricated structure was relevant in deciding whether it was "immovable". The UK Upper Tribunal had applied that decision in *UK Storage Company (SW) Ltd*. Both parties were in agreement that the length of the lease, the fact that the units had previously been used on a different site and were subsequently used elsewhere and that it was conceded that the units were not "inseverably fixed to or in the ground" were not relevant and that the Tribunal had to look at the objective characteristics of the structure.

HMRC pointed out that this was a two-storey structure requiring planning permission. It had required foundations to be set in the ground, and had taken the appellant 48 days to deliver it, construct it and fit it out, and it took 14 individuals 7 days to dismantle and remove it.

The appellant argued that the units were not fixed to the ground and dismantling them was a straightforward exercise. The number of units involved did not make any difference, and the requirement for planning permission was nothing to do with VAT law.

The Tribunal examined the installation and removal process in some detail. The judge noted that there was a conflict between the arguments of the parties: HMRC wanted to consider the combination of 66 prefabricated units into one substantial building, while the appellant argued that the proper test was to consider each component individually. The Tribunal concluded that the proper *Maierhofer* test was nearer the appellant's position: it was necessary to consider whether each unit was fixed to the ground.

The connections to the ground were in three possible forms: foundation trenches, levelling beams and friction clamps; mains services; and two external staircases. The judge did not consider that any of these were so fundamental as to establish that the units were fixed.

The length of time taken to dismantle and remove the units arose mainly from the number of them, rather than the difficulty of the exercise. They were within the same bounds as *UK Storage* and *Maierhofer*. The units were movable property, and the appeal was allowed.

First-Tier Tribunal (TC05253): *Sibcas Ltd*

3.1.3 Timeshares

A company sold "fractional interests" in a high value property in Mayfair. In return for a substantial upfront price, a purchaser acquired the ability to occupy a residence in the property of a specified category for a maximum number of nights in each year until 31 October 2050, and to access a range of related benefits during that period. These included the option of exchanging stays in other properties and receiving rental income.

The company argued that it simply provided a licence to occupy land. It was not providing accommodation in "a hotel, inn, boarding house or similar establishment" (VATA 1994 Sch.9 Group 1 Item 1(d)), nor was it providing holiday accommodation.

HMRC responded that the appellant did not provide any interest in land capable of falling within the exemption, but rather a taxable service of a right to participate in a bundle of benefits. If it was a supply of land, it was excluded by item 1(d).

The marketing material and website testimonials showed that some customers regarded the property as similar to a luxury hotel, but others treated it as a "second home". The Tribunal did not consider this to be significant one way or the other.

The Tribunal went on to examine the agreements in detail. The company pointed out a number of significant differences between the rights of a member and the rights of a hotel customer. For example:

(1) Members are required to pay an Annual Residence Fee which covers all running costs of the property and a sinking fund to replace mechanical and other assets. There is no such overt contribution to such costs for hotel guests.

(2) Hotel guests pay a nightly fee only whereas members pay a substantial upfront purchase price plus the Annual Residence Fee.

(3) A hotel guest has no influence over costs whereas the members have some influence through the Members Committee which agrees the Annual Operating Budget and Annual Residence Fee.

(4) A hotel guest has the right to enjoy the residence for the period of the booking only whereas a member has rights to occupy up to 31 October 2050.

(5) A hotel guest cannot leave personal belongings between stays whereas a member can do so.

(6) Unlike a member, a hotel guest cannot rent his room or sell his right to occupy it or use his interest as security.

The appellant argued that the CJEU's decisions in *RCI Europe* (Case C-37/08) and *MacDonald Resorts* (Case C-270/09) showed that its supplies

should be regarded as supplies of land. Several other precedents were cited in a comprehensive defence of the company's position.

Both sides agreed that it was necessary to consider the commercial reality and all the surrounding circumstances. The Tribunal considered that it was clear that the members were paying the substantial upfront price in return for the right to occupy a residence in a desirable location in the heart of Mayfair in London for a maximum period of time each year on an ongoing basis over many years. The use of other programmes offered by the manager was optional and secondary. Unlike *MacDonald Resorts*, there was certainty at the time of supply what property would be involved; that was enough to make it a letting of immovable property. There was nothing in the *Card Protection Plan* principles to change the nature of this principal supply.

The Tribunal went on to consider the "hotel exclusion". It noted that the CJEU had considered (*Blasi v Finanzamt Mnchen I*, Case C-346/95) "the duration of the stay" relevant in applying the exemption: temporary accommodation would compete with the hotel sector, and should therefore be taxable. A German rule requiring a six-month lease before exemption applied was held not to be incompatible with the Directive. The Tribunal rejected the appellant's arguments that the length of the agreement was relevant (many years) – it was the length of the stay in each year that suggested it should be treated as temporary accommodation similar to that supplied by hotels.

The Tribunal considered the differences between the rights of a member and a hotel guest, and between the rights of a member staying in the property and a non-member (who, it was accepted, would be paying for taxable hotel accommodation). Those differences did not seem as significant as the similarities. The hotel exclusion applied, and the appeal was dismissed.

First-Tier Tribunal (TC05318): *Fortyseven Park Street Ltd*

3.2 Option to tax

Nothing to report.

3.3 Developers and builders

3.3.1 Village hall or similar

A registered charity which operated a rugby club constructed a new clubhouse on the site it leased from Highland Council. HMRC ruled that it could not be zero-rated. This would add some £60,000 to the cost, of which £95,000 had been raised by the club through fundraising events, the balance coming from various grants.

The club's president gave evidence to the FTT (TC04560) about the use of the clubhouse. It was used by a wide range of community groups. Although rugby took priority, so that others could not use it on a Saturday afternoon in the season, that did not undermine the fact that it was used in a similar way to a village hall.

HMRC relied on the funding application, which did not describe the level of outside use that it appeared had actually occurred. It was the intention at the time of construction that determined the liability, and it was for the club to show that zero-rating was justified. The person who completed the funding application was not available to give evidence, and HMRC said that "was the club's problem".

The FTT considered a number of precedents, and noted the following questions were suggested as crucial in *New Deer Community Association*:

(1) Were the facilities provided for the local community?

(2) Was the facility owned, organised and administered by the local community?

(3) Were social or recreational facilities provided or reasonably capable of being provided?

(4) Was the use similar to the use of a village hall?

The funding application was important, but had to be considered in conjunction with all the other evidence. Given that the wide range of use had been present from the time of construction, that was an indication of an intention for such varied use. HMRC's different arguments were rejected in turn. The judge was satisfied that all the requirements of Group 5 Note 6(b) were met: the building was used, and intended to be used, by a charity for purposes similar to those of a village hall in that they benefited the local community. The appeal was allowed.

HMRC appealed to the Upper Tribunal, arguing that the FTT had erred in law in finding that there was an intention solely for use as a village hall or similarly. HMRC contended that note 6(b) required local community direction or control of the use of the building. This might be exercised in different ways, for example by the local community electing representatives to the managing body for the building, but there had to be practical and effective community control.

The UT did not agree. A lack of community control would be a factor in the consideration, but it was not a decisive one. The use of the building could be intended to be for the local community, even if the local community did not direct or control that use. It had therefore been open to the FTT to come to the conclusions it did. The appeal was dismissed.

Upper Tribunal: *HMRC v Caithness Rugby Football Club*

3.3.2 Retirement village

A company controlled by an order of nuns constructed a retirement village of self-contained apartments with communal facilities. The question arose of whether buildings containing those communal facilities could benefit from zero-rating. After some dispute, it was accepted that the construction of a café, launderette and hair salon was standard rated and that five self-contained apartments were zero-rated. The issue that remained was whether services in the course of construction of the communal leisure facilities and subsequent grant of a major interest could be zero-rated.

The judge noted that retirement villages do not count as relevant residential purpose buildings. If they did, the communal facilities could have qualified for zero-rating. The legislation made specific provision for "a separate building occupied with a dwelling" in the case of garages; other separate buildings were by implication not covered. The appellant's counsel made a number of appeals to fiscal neutrality by reference to different arrangements of flats with communal facilities, but the judge was satisfied that those were different sets of facts and not enough to override the clear words of the law. The appeal was dismissed.

First-Tier Tribunal (TC05316): *St George's Augustinian Care*

3.3.3 Garden wall

HMRC assessed a builder to £12,850 in respect of input tax claimed on a development site. At the time of the supposedly zero-rated sale of the site, the only thing that had been constructed was a garden wall. In addition, planning consent was granted retrospectively to allow the development. The project involved the demolition of a semi-detached house, making good the exposed gable end of the other house, the construction of a new boundary wall and then the construction of a new detached house. The property was sold on before the construction of the new house had started; the new purchaser applied for a second planning permission to cover changes to the specification from the original project.

The Tribunal considered a number of precedents concerning what constituted "in the course of construction", and agreed with the appellant's counsel that this project had gone beyond merely preparatory works. The question was, however, whether the wall constituted a "building", which was less clear. The judge decided that it was right to consider the project as a whole: the wall was a building, and in the context of the project, it was part of a building designed as a dwelling, so the vendor was a "person constructing".

Unfortunately, the planning consent did not allow for the building of the wall in that form at the time of the supply. There were complex issues concerning the changes to the consent and the changes to the design, but the judge concluded that Note 2(d) must be satisfied at the time of the supply, and it was not. Retrospective consent was granted in August 2012, but that could not affect a supply made in May 2012. The appeal was dismissed.

First-Tier Tribunal (TC05356): *Cavendish Green Ltd*

3.3.4 Listed building

A dispute arose over whether certain works were carried out in the course of approved alteration of a listed building and therefore qualified for zero-rating. There was a convoluted history in the appeal: the Tribunal had already considered the matter several times, initially striking it out because HMRC had not made an appealable decision, then allowing the appeal to be restored because that first Tribunal had not considered all the relevant submissions.

When it finally came before the Tribunal again, the appellant applied for costs in relation to the strike-out application. It was therefore necessary for the Tribunal to consider the history, as well as the technical point.

The works had been carried out to the roof of a carriage house. The main works had been accepted by HMRC as approved alterations in the course of converting the carriage house into a dwelling. The dispute related to works carried out by a secondary contractor, where HMRC considered them to be "repairs and maintenance". The Tribunal considered that it was irrelevant to consider the works carried out by the secondary contractor on their own – it was proper to consider the whole project, which was certainly an alteration to the building. These works were part of that project, so they were carried out in the course of an approved alteration. The judge did not consider the legislation to intend the dissection of a project that was, overall, an alteration into some elements of repair and maintenance and some that qualified. He described as "the error in HMRC's approach" the view that the legislation required services to be both works of alteration to a protected building (as opposed to works of repair and maintenance) AND made in the course of an approved alteration. In his view, the requirement was that the works, viewed as a whole, had to be an approved alteration rather than repair and maintenance.

The appeal on the substantive matter was therefore allowed. On the costs issue, the Tribunal reviewed the correspondence and agreed that there was no appealable decision in a letter of December 2012. The officer had explained that HMRC would not give a ruling on liability in the circumstances, and referred the appellant to HMRC's complaints procedure. It had therefore been correct for the original Tribunal to strike out the appeal, and it could not have been unreasonable for HMRC to have brought or carried on the proceedings. The costs application was dismissed.

First-Tier Tribunal (TC05338): *Robert Morfee*

3.3.5 Dwellings formed from more than one building

HMRC have issued a Brief to announce a change in policy in relation to dwellings that are formed of more than one building. Following two FTT decisions released in 2012, they accept that this is possible provided that the buildings are either constructed or converted under a single project and single planning consent. Refund claims arising as a result of the changes announced in this brief may be submitted with retrospective effect up to 4 years from 23 August 2016 (subject to "unjust enrichment").

The cases were *Mark Catchpole* (TC01995) and *T Fox* (TC01957). HMRC accept that the law should be interpreted as allowing several

buildings together to form a single dwelling, as long as they are designed to function together for that purpose. In order to be eligible for the zero-rate, the buildings must meet all the following:

- the development must meet the conditions of a 'building designed as a dwelling' and to this end 'building' can mean more than one building;
- all buildings must be constructed or converted under a single project and under a single consent;
- if a new dwelling that is made up of more than one building is constructed in stages, HMRC will view subsequent stages as annexes to the original building, which will not benefit from the zero-rate unless the buildings are on the same site and:
  - the stages are completed with no unreasonable delay between them
  - none of the buildings are occupied until all the stages are complete (in the sense described at Section 3.3.2 of VAT Notice 708: *Buildings and construction*).

Where work is undertaken to convert premises consisting of more than a single building into a dwelling (for example, where premises are being converted to a different residential use), HMRC now accept that it would qualify for the reduced rate (5%) of VAT.

Revenue and Customs Brief 13/2016

HMRC have updated their Notice *Buildings and construction* to cover this policy change. They have also made a number of other detailed amendments, for example:

- Paragraph 2.1.3 Clarification of the position relating to subcontractors services in relation to work undertaken on vacant properties.
- Paragraph 4.5 has been amended to show when person constructing status may be transferable.
- Paragraph 5.5 has been amended to show when person converting status may be transferable.
- Paragraph 11.2 has been clarified to explain the correct liability of the incorporation of goods that are not building materials in a reduced-rated project.

Notice 708

3.4 Input tax claims on land

3.4.1 DIY claims

A DIY builder appealed against the refusal of a claim for a refund of £11,871. The problem was that the planning consent at the time the project was carried out was for the alteration and extension of an existing building. For various reasons, the building was instead demolished and a new one constructed. It appeared that this was as a result of inspections

of the old foundations by the Council's Buildings Inspector (who decided they were inadequate and would have to be replaced), but the Council had no record of the plan changing from alteration to demolition. The planning permission was regularised retrospectively. As is normal in such cases, that makes the development legal but it cannot validate the VAT claim – the project must be carried out in accordance with the planning consent that exists at the time the work is done. That was the Upper Tribunal's 2015 decision in *HMRC v Patel*, and that was binding on the FTT. The appeal was dismissed.

First-Tier Tribunal (TC05323): *Marie Reynolds*

In 2013 an individual bought a property that in 1997 had comprised three barns. The vendors had carried out some conversion works and had lived in the property. The purchaser carried out further works to make the properties habitable, and claimed a DIY builder's refund. HMRC refused, on the grounds that the property had been residential before he had begun his project. His argument was that the project of conversion had started in 1997, when the property was definitely not residential.

The judge considered that the wording of the legislation confirms that the works carried out by the claimant have to qualify on their own; they cannot be amalgamated with works carried out by someone else. Because the vendors had lived in the building before he bought it, the claimant had not converted a non-residential building, and his appeal was dismissed.

First-Tier Tribunal (TC05380): *William Steynor*

A DIY claimant was repaid most of the VAT he claimed in respect of a new house, but a dispute remained over one particular invoice. HMRC refused the claim because they considered the purchase had been made after the date of completion. The judge examined the evidence, provided in a substantial folder by the appellant, and concluded that the invoices represented "supply and fit" of something other than fitted furniture. They should therefore have been zero-rated. The appeal against HMRC had to fail, but the judge suggested that the appellant should go back to the joinery company and ask for a refund.

First-Tier Tribunal (TC05368): *Richard Hall*

3.5 Other land problems

3.5.1 Articles

In an article in *Taxation*, Neil Warren considers the VAT aspects of incorporating a residential property business, following another article by Peter Rayney about the direct tax and SDLT aspects of a similar transaction.

Taxation, 4 August 2016

In an article in *Taxation*, Simon Linley and Elizabeth Robertson consider a number of potential tax problems with land sales, covering capital gains, SDLT, VAT and even inheritance tax.

Taxation, 18 August 2016

4. INTERNATIONAL SUPPLIES

4.1 E-commerce

Nothing to report.

4.2 Where is a supply of services?

4.2.1 Airtime

A company treated sales of "airtime" as outside the scope of VAT because the customer belonged in Italy. HMRC raised an assessment for nearly £65,000 in respect of the period 12/10 and £179,000 for 03/11.

The Tribunal had issued directions in relation to the hearing on 29 October 2015. HMRC missed the deadline for delivering witness statements by 8 days, and applied for an extension of time for submission of their skeleton argument at 4.30pm on the deadline day (23 May 2016, 14 days before the hearing). The taxpayer's representatives objected to the application and applied for HMRC's case to be struck out with costs. The skeleton argument was filed on 24 May.

The Tribunal considered these matters as preliminary issues. It was satisfied that the *BPP* case was not relevant, because that was about whether a party should be relieved from the effect of sanctions already imposed (barring); this was a more normal question of whether there was a valid reason for the delay, and whether the delay was serious. The Tribunal accepted HMRC's explanations (of an administrative mix-up) and allowed their application.

The Tribunals Rules allowed for the imposition of sanctions on HMRC in specific circumstances, none of which had been reached in this case (e.g. breach of an "unless" direction, complete failure to cooperate with the Tribunal). The appellant's application was therefore refused. The judge commented:

"We think we should make it plain that it is wholly inappropriate for litigants or their lawyers to take advantage of mistakes made by opposing parties in the hope that relief from sanctions will be denied and that they will obtain a windfall strike out or other litigation advantage. In a case where (a) the failure can be seen to be neither serious nor significant, (b) where a good reason is demonstrated, or (c) where it is otherwise obvious that relief from sanctions is appropriate, parties should agree that relief from sanctions be granted without the need for further costs to be expended in satellite litigation. The parties should in any event be ready to agree limited but reasonable extensions of time up to 28 days as envisaged by the new rule 3.8(4)."

Turning to the substantive issue, the Tribunal examined the history of the business and its dealings. There was some doubt about the nature of the counterparty, because the Italian tax authorities had told HMRC that their enquiries suggested that the declared customer did not know the UK supplier. The judge also noted that HMRC used "officialese" in describing what had gone on – technical language that accountants and lawyers might understand, but language that would not be used or

understood by the people carrying on a business. It was necessary to bear that in mind when interpreting how the appellants described what they were doing.

The judge considered that HMRC had adopted a "blinkered approach" in assuming that something was seriously wrong and interpreting the evidence in that light. Their major evidence was a report from the Italian tax authorities that was translated by the Italians into English; it included the results of enquiries made by the Italians to a non-native Italian speaker, the supposed counterparty. The judge placed little weight on this report because of the possibility of language mix-ups.

The judge was satisfied that the appellants had established a prima facie case that they had supplied airtime to a counterparty established in another member state, and HMRC had not done enough to display that prima facie case. In particular, although HMRC referred to a lack of due diligence, it was not clear that a company in this position was required to carry out due diligence. There was no question of Notice 726 having been issued to the company. The appeal was allowed.

First-Tier Tribunal (TC05227): *Essential Telecom Ltd*

4.2.2 Indemnity repairs

The Value Added Tax (Place of Supply of Services: Exceptions Relating to Supplies Made to Relevant Business Person) Order 2016 takes effect on 1 October 2016. It is an anti-avoidance measure to prevent arrangements reducing the VAT cost on repairs carried out for insurers who are based outside the EU, if the repairs are used and enjoyed in the UK.

It inserts a new exception to the normal rules for place of supply of services in Sch.4A VATA 1994. The new para.9D applies where services consist of the repair of tangible moveable property, the supply is made pursuant to a contract of insurance, and the supply is made to a relevant business person who is not the person insured. The "use and enjoyment rules" will then apply:

- Where such a supply of services would otherwise be treated as made in the UK (i.e. the customer belongs in the UK), and the services are effectively used and enjoyed outside the EU, the supply is to be treated as made where it is used and enjoyed.
- Where a supply of services to which this paragraph applies would otherwise be treated as made outside the EU (i.e. the customer belongs outside the EU), and the services are effectively used and enjoyed in the UK, the supply is to be treated as made in the UK.

SI 2016/726

A Tax Impact and Information Note has been issued to comment on the changes. It is not expected to have a significant impact, but it prevents those using avoidance arrangements from gaining a competitive advantage.

www.gov.uk/government/publications/vat-use-and-enjoyment-of-insurance-repair-services

HMRC have issued a Brief and also an updated version of (from August 2016) Notice 741A to describe the changes further. The Brief clarifies

that the new rules cover the situation in which the contracts provide that the supply of repair services is made directly to the insurer, rather than to the insured person with the insurer simply paying for it. The tax avoidance scheme in *WHA Ltd*, which concerned indemnity repairs, failed because the courts decided that the place of supply was in the UK under normal rules. It seems that the law has been changed to cater for contracts that have been more effectively drafted with VAT in mind.

Revenue & Customs Brief 15/2016; Notice 741A

4.3 International supplies of goods

4.3.1 Warehousekeeper and import VAT

A company claimed import VAT of just over £500,000. There was a preliminary issue before the Tribunal of whether HMRC had made an appealable decision. Although no formal decision had been issued setting out rights of review and appeal, the Tribunal was satisfied that a decision could be inferred from the conduct of the officer in blocking input tax credit. Late appeals would be accepted because there was a good reason for the short delay and the prejudice to the taxpayer of refusing an application would be significant.

The company provided "fulfilment services" in arranging for delivery of goods purchased by consumers in the UK from suppliers in China. When the goods arrived in the UK, they had already been sold by the supplier to a UK customer. The company never took title to the goods. The import VAT was paid by a freight agent and invoiced to the company, which claimed it as input tax. Its income was in the form of a service charge invoiced to the supplier in Hong Kong.

The company argued that the goods were part of its business, and the VAT on the goods was therefore incurred as an essential cost. HMRC responded that the goods were incidental to the service it provided, albeit a necessary prerequisite, and they were not cost components of its supplies. The company was reimbursed for the VAT by the Hong Kong supplier; if it was also reimbursed by HMRC, the company would enjoy a double relief, and the goods (consumed in the UK) would not be subject to VAT.

The Tribunal agreed with HMRC's contentions. The cases cited by the appellant were not relevant; the VAT on the goods was not proper to the appellant. The appeal was dismissed.

First-Tier Tribunal (TC05223): *Donsaw Ltd and others*

4.3.2 Warehousekeeper's breach

A company appealed against the issue of post clearance demand notices from HMRC in respect of timber unlawfully removed from a customs warehouse for which it was the warehousekeeper. The charge was for £394,000 of customs duty and £1.2m of import VAT. As a preliminary issue, the Tribunal considered whether, if the warehousekeeper was indeed liable for the VAT, it would be able to deduct it as input tax.

The taxpayer's counsel argued that it was fundamental to the warehousekeeper's business that it had to accept joint and several liability for VAT with its customers in order to be authorised by HMRC. Any VAT that it had to pay was therefore fundamentally linked to its business activity. A fully taxable trader should not suffer the cost of VAT. Numerous CJEU precedents were cited in relation to the deduction of VAT on overhead costs, from *Rompelman* to *Sveda*.

Judge Berner did not accept these arguments. The right to deduct was defined by PVD art.168, and the company did not meet the conditions. The timber was not supplied to it for the purpose of its taxable transactions. It had not imported the timber itself, but rather had incurred a liability to pay someone else's VAT. The company argued that it would be perverse to deny it a deduction when the primary debtor (the importer, which was insolvent) would have been able to deduct the VAT as input tax – so the secondary debtor would have a higher net liability than the primary debtor. The judge considered that the right to deduct was clearly defined in art.168; it did not apply, and there was no need to refer a question to the CJEU. The preliminary issue was decided against the taxpayer.

First-Tier Tribunal (TC05241): *Associated British Ports*

4.3.3 Article

In an article in *Taxation*, Neil Warren discusses a situation in which a national shipping agent had incorrectly completed an import declaration, showing as the customer someone who had not bought it. The article advises contacting HMRC to resolve disputes between businesses about the technicalities of the VAT rules, as the "big business" does not always know the correct answer.

Taxation, 30 June 2016

4.3.4 Export conditions

A company appealed against assessments for just over £200,000 in relation to transactions which had been zero-rated as exports to the Republic of Ireland. The trader had been registered for some time as a "vehicle consultant"; he had been visited and had discussed due diligence with officers. The disputed transactions involved purchases of cars from Germany, Cyprus and Malta, which were then sold to business customers registered in Eire. HMRC were not satisfied that the evidence was sufficient to show that the goods had left the UK as stated by the trader.

The appellant argued that the cars were in fact not in the UK at the time that the invoices were raised to the customer. This meant that UK VAT was not due, and the Tribunal should not consider whether VAT had been correctly accounted for elsewhere, because that was not relevant to the question before it. Alternatively, the evidence was sufficient to show that the goods had left the UK; or, under *Teleos*, the trader should be entitled to zero-rating on the basis of having done everything reasonable to ensure that the goods had left the UK.

The Tribunal was not satisfied that the evidence proved that the goods were outside the UK at the time of supply. Even if they were, the Tribunal considered that the place of supply would still be the UK under

s.7(7) VATA 1994: the place of supply cannot be determined under the preceding provisions and the Appellant's supply involved the removal of the goods from the UK. The supplies were not therefore made directly from Germany, Cyprus and Malta. Although the facts were not the same as those in the *Euro Tyre Holdings* case, the Tribunal considered its conclusion was strengthened by that precedent.

The evidence was not sufficient to show that the goods had left the UK. The Tribunal did not accept that *Teleos* applied, because the trader had not taken all reasonable steps to be satisfied that the documents reflected what had happened: his due diligence was very poor. In any case, *Teleos* was different in that it involved a change of position by HMRC, who had originally accepted documentation and then sought to assess on the basis that it was forged. The appeal was dismissed.

First-Tier Tribunal (TC05378): *I C Wholesale Ltd*

4.3.5 Updated Notices

HMRC have updated the new Notice *Customs special procedures for the Union Customs Code*, adding details of the four new 'bill of discharge' forms for inward processing and end-use relief.

Notice 3001

HMRC have updated their Notice *Visiting forces* which deals with zero-rating sales in certain circumstances. It reflects the introduction of procurement using a new NATO purchasing card.

Notice 431

HMRC have updated their Notice *Classifying your imports or exports*. It deals with classification and with applying for a Binding Tariff Information decision. Under "What's changed?" it refers to a new system for applying for BTI rulings from 1 April 2014, even though the update was made on 6 July 2016.

Notice 600

HMRC have updated their Notice VAT *Retail exports*, which explains how zero-rating and the refund scheme work from the viewpoint of traders. It now includes a link to a list of EU countries.

Notice 704

HMRC have updated their Notice *Tax free shopping in the UK*, which is aimed at consumers. The only revision appears to be new address for comments.

Notice 704/1

HMRC have updated their Notice *The single market*, replacing the June 2013 version. The main changes appear to be the inclusion of Croatian VAT numbers and a change to the format of Irish numbers.

Notice 725

HMRC have updated their Notice *Customs Freight Simplified Procedures*. It has been substantially updated to include changes in procedure from the introduction of the Union Customs Code.

Notice 760

4.4 European rules

4.4.1 EU VAT gap

The Commission has published the figures for the theoretical EU-wide VAT gap for 2014. There was a slight fall, by €2.5bn (0.7%) to €160bn (14%). The VAT Gap rate ranged from a high of 37.9% of uncollected VAT in Romania to a low of only 1.2% in Sweden. In absolute terms, the highest VAT Gap of €36.9 billion was recorded in Italy while Luxembourg had the lowest of €147 million.

The report highlights a problem with the interpretation of these figures: it accepts that the VAT gap "refers to more than just fraud and evasion. It also covers the VAT lost due to, for example, insolvencies, bankruptcies, administrative errors, and legal tax optimisation."

The UK's VAT gap is estimated to have gone up by 0.2%, from €15.7bn to €17.7bn.

IP/16/2936; https://ec.europa.eu/taxation_customs/sites/taxation/files/2016-09_vat-gap-report_final.pdf

4.4.2 Consultation on reduced rates

The European Commission ran a consultation until 19 September 2016 on proposals to allow member states to apply reduced VAT rates to electronically-supplied publications. This follows a commitment made in the Commission's 2016 VAT action plan to allow member states to apply the same VAT rates to electronically-supplied publications as currently apply to printed publications. The PVD explicitly provides that electronic publications must be taxed at the standard rate, and both Luxembourg and France have been subjected to infringement proceedings for applying lower rates; books on "physical means of support" can be lower rated.

ec.europa.eu/taxation_customs/common/consultations/tax/super_reduced_rates_vat_en.htm

4.4.3 Charge on cessation

A Polish notary incurred VAT on the construction of a building that was used partly for private and partly for business purposes. He only claimed a deduction for the business element. The building was subject to the capital goods scheme. He asked for a ruling on whether the business element of the building would be subject to an output tax charge on the cessation of his economic activity, even though the CGS adjustment period for the building had expired. Questions were referred to the CJEU.

The opinion of Advocate-General Kokott was that the rules on taxation of private use and the rules on adjustment of input tax deduction have similar objectives, but they are independent of each other and are to be applied separately. If there was a risk of double taxation in the application of both rules, that should be taken into account in order to preserve fiscal neutrality; but the A-G did not consider that there was any double taxation in the present case. The rules on the cessation charge provided that there should be no output tax if there had been no input tax deduction; in this case, the input tax would have been deducted, so the charge on cessation was a single charge that would reflect private use after cessation.

The full court agreed with the opinion, holding that art.18(c) applied to impose a charge on cessation, where input tax on goods had been deducted on acquisition, even after the adjustment period in art.187 had ended.

CJEU (Case C-229/15): *Minister Finansów v Jan Mateusiak*

4.4.4 Transitional rules

Under a transitional provision, the supplies of lawyers' services in the course of their usual activities were exempt from VAT in Belgium up to 31 December 2013. They had been exempt when the VAT Directive entered Belgian law in 1971, and remained so under a derogation in accordance with art.371 PVD. The exemption was abolished by Belgian law with effect from 1 January 2014.

Some lawyers argued that this would lead to a number of problems that made it unlawful – in particular, the possible 21% increase in the cost of lawyers would reduce access to justice. The questions referred were many and detailed, covering a number of possible "solutions". A-G Sharpston gave an opinion that the transitional exemption accorded with the Directive, and it could have been restricted without being wholly abolished; but having abolished it completely, Belgium could not reintroduce any aspect of it. There was no scope for exempting legal services under any other provision of the PVD; in particular, legal aid work could not be brought within "welfare and social security work" under art.132(1)(g). The charging of VAT on lawyers' services did not breach any principles of international law or agreements.

The full court has agreed with the opinion. Art.47 of the Charter of Fundamental Rights of the EU, which provides for the right to an effective remedy and the principle of equality of arms, did not invalidate arts. 1(2) and 2(1)(c) PVD as they applied to lawyers' services, and the exemption in art.132(1)(g) could not be applied to legal aid services.

CJEU (Case C-543/14): *Ordre des barreaux francophones et germanophone and others v Conseil des ministres*

4.4.5 Descriptions in invoices

The *Barlis* case concerns a question that has been before the UK Tribunal several times recently – how detailed a description of the supply is required for an invoice to comply with the law and permit the customer to deduct input tax.

A-G Kokott considered that descriptions such as 'legal services rendered from such a date until the present date' or 'legal services rendered until the present date' were not sufficient to satisfy the law and therefore to justify input tax deduction for the customer.

The question referred noted that the authority might be able to obtain more information about the nature of the supply "in accordance with the principle of collaboration". The A-G considered that the supplier has to make the correction – it cannot be provided by the person claiming a deduction, or by the authorities.

She pointed out that the purpose of the description is to make sure that the correct provisions are applied to the supply. For example, some legal

services are subject to a lower rate under Portuguese transitional provisions. The description was therefore insufficient to enable the authorities to carry out their monitoring function.

The full court noted that the questions only referred to art.226(6) PVD. To give a useful answer, the court extended its considerations to art.178(a) and art.226(7). The court agreed with the A-G that the descriptions were inadequate. In particular, an invoice for a continuous supply of services must specify both the beginning and end of the period during which the services were supplied; it was not enough to state "legal services rendered until the present date" (although "rendered from [date] to [date]" could be acceptable).

It was for the referring court to determine whether the additional information supplied by the trader could be treated as documents amending the initial invoice in accordance with art.219 PVD.

The second part of the question concerned the right of the trader to deduct the input tax. The court reaffirmed the principle that the right to deduct is absolute, and cannot be refused by the authorities on the basis of some formal failure if it is agreed that the substantive conditions are met. The authorities are required to take into account additional information provided by the taxable person and to decide whether the substantive conditions are met.

The authorities are permitted to levy a fine for failure to comply with the formal conditions, but not to deny the deduction altogether.

CJEU (Case C-516/14): *Barlis 06 — Investimentos Imobiliários e Turísticos SA v Autoridade Tributária e Aduaneira*

4.4.6 Correcting invoices

A German company was discovered on a VAT inspection to have deducted input tax on the strength of non-compliant invoices. The company obtained corrected invoices, but the tax authority maintained that deduction was still not possible. Questions were referred to the CJEU.

The A-G gave an opinion that the principle of neutrality requires that a trader who has met the substantive requirements for deduction should be allowed to correct defects in invoices and retroactively qualify for deduction. An absolute denial of deduction appeared disproportionate, and rendered the exercise of rights either impossible or excessively difficult.

Part of the question related to the period in which the deduction could be made. The German authorities accepted a deduction in the later period in which the corrected invoice was obtained, but then an interest charge (and possibly penalties) could arise in the meantime. The German government regarded that as the application of the judgment in *Terra-Baubedarf-Handel* (Case C-152/02). The A-G considered that the correction should fall in the period in which the supply was received, in line with the principle that the right to deduct arose immediately on receiving an input. The A-G distinguished the earlier case in that it concerned the original issue of an invoice: the company did not have a right to deduct until it held one. In the present case, the company had an invoice, but it was defective. The A-G considered that a crucial distinction.

The full court has essentially agreed with the A-G, requiring any denial of input tax credit on the basis of inadequate documentation to comply with the principles of equivalence and effectiveness. A prohibition on corrections appeared an excessive measure, rendering the exercise of the right of deduction practically impossible or excessively difficult.

The court confirmed that the correction of an existing invoice was different from the complete absence of an invoice as in *Terra-Baubedarf*. The right to deduct fell in the period in which the supply and the original invoice were received, not in the period in which the invoice was corrected.

The court's answer was that the German legislation, prohibiting retroactive effect of the correction, did not comply with the PVD.

CJEU (Case C-518/14): *Senatex GmbH v Finanzamt Hannover-Nord*

4.4.7 Carousel fraud

Advocate-General Wathelet has given an opinion about the application of the PVD to greenhouse gas emissions allowances. The question arose in relation to an alleged carousel fraud. The way in which the A-G describes the fraud is possibly more complex even than some of those described in UK Tribunals: Company E, which was resident in Germany and controlled in practice by G, acquired greenhouse gas emission allowances abroad, exempt from VAT, and transferred them to company I, which was resident in Luxembourg and also controlled by G. I issued invoices in the form of credit notes to E which included the VAT applicable in Germany and sold the allowances to company C, which was resident in Germany; the credit notes issued for that transaction also included the VAT applicable in Germany. E declared the turnover from the sale of allowances to I but offset input tax on the basis of false invoices from fictitious domestic suppliers, evading payment of €11m. I declared the supplies to C and claimed the VAT included in the credit notes issued to E, evading payment of €10m.

The case involved prosecution of two tax advisers, A and B, who had filed tax returns for I on the basis that it had a place of business in Germany and should therefore be charged German VAT by E that it could claim back on a German VAT return. If I was only established in Luxembourg, the place of supply of "similar rights" under art.56 PVD would be Luxembourg, and it would be incorrect to treat a supply by a German company as carrying German VAT.

The A-G noted that he had to confine his considerations to the VAT law and disregard the possible criminal law consequences of the outcome, which was a matter solely for the referring court. He noted that specific rules had been introduced into the PVD with effect from 1 April 2010 (art.199a) to allow Member States to apply a reverse charge to emissions trading, which might suggest that it was not subject to the reverse charge beforehand.

The A-G considered the nature of the other rights covered by art.56 and a number of precedent cases, as well as what he considered to be the purpose of the law. In his opinion, a right to emit greenhouse gases was covered by "similar rights", and the reverse charge would therefore have applied even before 1 April 2010.

The fact that this was sufficiently uncertain to require a reference to the CJEU may be used by the defence in the prosecution in Germany. According to the reference, the advisers were not aware that the transactions were an orchestrated fraud, but only advised on the VAT returns submitted by I.

CJEU (A-G) (Case C-453/13): *Criminal proceedings against A, B*

4.4.8 Digital publications

The Polish court referred questions to the CJEU about the principle of equal treatment and the rule that requires standard rate VAT to be charged on digital publications, but allows member states to apply lower rates to the same information "on physical means of support".

A-G Kokott considered that the different treatment was justified. Although the information supplied might in both cases be within the overall objective of the lower rate in encouraging education of EU citizens, and although the products might compete with each other, the differences between the products were sufficient to justify different treatment. The costs of production and distribution of electronic services were so much lower that they were often offered at a lower price, even though they carried a higher rate of VAT.

The A-G also considered that the imposition of a special regime on electronic services required the difference in treatment, and that was a further justification for the distinction between the types of product.

CJEU (A-G) (Case C-390/15): *Rzecznik Praw Obywatelskich (RPO)*

4.4.9 Margin scheme

A Danish business buys "end-of-life" vehicles and strips out useable parts for resale. The purchases are not subject to VAT. Questions were referred to the CJEU to determine whether the company was eligible to use the margin scheme for its sales, given that it was not selling the things it bought in the same form.

Advocate-General Bot has given an opinion that the margin scheme should extend to such activities, in accordance with the EU's fundamental principles of encouraging the reuse and recovery of waste. This would be undermined if taxable dealers were required to account for output tax on the full selling price without any deduction in relation to their costs.

The Danish government argued that the wording of art.311 required the second-hand goods to be sold in the same state: "movable tangible property that is suitable for further use as it is or after repair". The A-G did not agree that this implied a requirement to exclude goods originating from a single whole which could be separated.

The A-G had to consider how the margin should be calculated, given that the transactions are more complex than those normally involved in second-hand margin schemes. In his view, "*the profit margin would be calculated for a given period. It would be equal to the difference between the sum of sales of spare parts effected during that period and the sum of purchases of such spare parts. The latter sum could be calculated by deducting from the sum of purchases of end-of-life motor vehicles the value of environmental and waste treatment, services for which Sjelle*

Autogenbrug charges a standard price, and the value of sales of scrap or any other services. Consequently, what would be left after deducting all those amounts from the purchase price of the vehicles would be a sum corresponding to the purchase price of all the parts taken from each vehicle for the period in question."

CJEU (Opinion) (Case C-471/15): *Sjelle Autogenbrug I/S v Skatteministeriet*

4.4.10 Bad debt relief conditions

An Italian business accounted for output tax on consideration that remained unpaid. Italian law only allows bad debt relief if the trader can prove that the non-payment has become "definitive", that is that insolvency procedures have been conducted and a final decision has been made closing the procedures. The trader argued that these restrictions were contrary to art.90 PVD and the principles of proportionality, effectiveness and neutrality. Questions have been referred to the CJEU.

CJEU (Reference) (Case C-246/16): *Enzo di Maura v Agenzia delle Entrate –Direzione Provinciale di Siracusa*

4.4.11 Limit on deduction

Italian law apparently places (or placed, in December 2000) a maximum limit on the amount of VAT that could be repaid or offset in a given year. A question has been referred by the Italian court to determine whether this is permitted.

CJEU (Reference) (Case C-211/16): *Bimotor SpA v Agenzia delle Entrate – Direzione Provinciale II di Torino*

4.4.12 Abuse of rights

The Irish court has referred questions to determine whether the principle of abuse of rights can be used by the revenue authorities even if there is no national legislation incorporating it into domestic law. There are a number of subsidiary issues, including the fact that the trader's transactions were carried out before the judgment in *Halifax* showed that the principle of abuse was applicable to VAT.

CJEU (Reference) (Case C-251/16): *Edward Cussens, John Jennings, Vincent Kingston v T. G. Brosman*

4.4.13 Delayed repayment

Art.183 PVD allows Member States to defer repayments to future periods rather than refunding the excess input tax in cash. The Hungarian court has referred questions about the detailed operation of this permissive provision. It appears that the authorities investigated a trader and eventually made a repayment, but only after several years and after fining the trader for breaches of regulations and non-compliance with the investigation. The questions ask whether the trader is entitled to interest, and if so from when.

CJEU (Reference) (Case C-254/16): *Glencore Grain Hungary Kft./Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatóság*

5. INPUTS

5.1 Economic activity

5.1.1 Mixed use expenditure

Under German law, the tax authorities can deny any deduction for input tax if the business use of the expenditure is below 10%. A local district authority disputed the lawfulness of this: it had claimed 2.65% of the VAT incurred on the purchase of machinery used to maintain roads, on the basis that this represented the proportion of its activities that involved making taxable supplies to third parties (such as cutting and trimming trees).

Germany had a specific authorising derogation to allow this rule (Council Decision 2004/817/EC). It was granted on 19 November 2004, but was supposed to expire on 31 December 2009. The dispute related to expenditure in the 2008 tax year.

The question before the CJEU was whether the derogation applied not only where expenditure was used for private purposes (e.g. of a sole trader), but also for non-economic purposes (as in the present case). The same distinction was drawn in the *VNLTO* case: "purposes other than those of the business" had to mean something outside the normal scope of the activities of the taxable person, such as private use by an employee, rather than something that was within those normal activities but for some reason outside the scope of VAT.

The CJEU ruled that the *VNLTO* decision clarified what the law had always been, rather than changing it. It should be used to interpret the derogation, even though it was decided in 2009. It would be contrary to the principle of fiscal neutrality and the fundamental objectives of the PVD to exclude the right of deduction in the present situation. The derogation had to be interpreted as not permitting the application of the German disallowance to "non-economic use within the purposes of the business".

CJEU (Case C-400/15): *Landkreis Potsdam-Mittelmark v Finanzamt Brandenburg*

5.2 Who receives the supply?

5.2.1 Legal fees

A company claimed input tax of nearly £80,000 incurred in relation to legal fees incurred in defending civil proceedings brought by another company against one of its directors. HMRC raised an assessment to disallow the VAT (together with a careless inaccuracy penalty, which was suspended). The company appealed, arguing that the VAT was incurred by the company in the course of its business.

The director was a former employee of the plaintiff, which sued him for breach of the conditions of his employment. Initially the plaintiff also threatened to sue the company he had set up in competition with it, but the

lawsuits that followed only involved the director and three other employees who had left to join his company. If the plaintiff had succeeded, it would probably have joined the company in a further action to account for lost profits. However, the director won in the Court of Appeal, and leave to appeal to the Supreme Court was refused.

The disputed invoices were addressed to the director at his home, but paid by the company. The director stated that he had always considered that the plaintiff was attacking both him and the company, and it was trying to put the company out of business. The very first invoice concerned the initial "letters before action" that were issued to both the director and the company: it was addressed to and paid by the company, and HMRC had not objected to the deduction of the input tax. The judge considered that there was no material difference between that invoice and the subsequent ones, and HMRC could and should accept the invoices as alternative evidence under reg.29. The relationship between the lawyers, the director and the company remained the same. The situation was similar to the *P&O Ferries* case. The link between the company's business and the lawsuit was much more direct and immediate than the general benefit of "keeping the owner out of jail" as in *Becker* or *Rosner*.

The appeal was allowed.

First-Tier Tribunal (TC05245): *Praesto Consulting UK Ltd*

5.3 Partial exemption

5.3.1 Banking supplies for consideration?

Two Dutch companies were members of a UK VAT group with a UK registered company. The group made voluntary disclosures between 2006 and 2011 claiming back input tax of £6m in total for the periods 10/02 to 03/11.

The company carried on a retail banking business in the UK, taking deposits from private individuals and paying interest. Its profit came from making investments with the deposited money. It was regulated by the Dutch financial authorities, and depositors were protected by the Dutch deposit protection scheme.

The company noted that the costs of attracting deposits were high, and many were VATable (e.g. advertising, construction and operation of call centres, IT services). By contrast, the VAT incurred on the investment side of the business was much less significant. The company charged no fees to depositors, and offered a higher rate of interest than most of its competitors. There were no branches – all interaction with the customers was by telephone or internet. Costs were kept low by offering few facilities – no cheque books, no debit cards, no ability to make payments to third parties.

The group agreed a special method in June 2004 to take effect from 1 April 2003. This noted that the banking operation only generated exempt income, and could therefore not recover any input tax.

The company's claim to recover VAT was based on the fact that some of its investments were made in non-EU interest-bearing bonds. It argued that these constituted "specified supplies" within SI/1999/3121, and therefore justified input tax recovery. HMRC regarded those investments as non-economic activity; the input tax incurred in the UK remained attributable to the exempt supply of banking services to retail customers, rather than to the use of the deposited money for making specified supplies.

The FTT judge (Barbara Mosedale, TC04051) noted that there was no real dispute about the law: "*Fundamentally, the dispute between the parties was whether IDUK made supplies for consideration to the depositors. It was assumed (rightly) that if IDUK made a supply of banking services to its depositors, then the costs IDUK incurred on its deposit taking activity had the most immediate and direct link to those banking services. Those banking services, if made, would be exempt and the attributable input tax irrecoverable.*"

The appellant argued that "receiving a loan" (i.e. the deposit) does not constitute a supply, nor is it consideration for a supply. There were references to this in the CJEU *BLP Group plc* decision (Case C-4/94), although it was not part of the basis of the judgment in that case. The funds were being raised to use in the business, so *Kaphag* (Case C-442/01) and *Kretztechnik* (Case C-465/03) were authority for the proposition that the input tax was attributable to all the business activities, rather than to any specific exempt supply.

Judge Mosedale had to consider the proposition that the bank made no supply to its customers, or if it made a supply of services, that supply was not made for a consideration; or, if there was a consideration, it could not be valued in monetary terms. There was authority in the High Court's 2006 decision in *MBNA Europe Bank Ltd* to show that a debtor does not make a supply merely by promising to repay the money lent.

HMRC pointed to a 1995 Tribunal decision, *Bank of Scotland* (VTD 13,854), in which Sir Stephen Oliver held that a bank did supply services to its customers. The appellant argued that this had been wrongly decided. The judge distinguished the situations: in the earlier case, there were other banking facilities (e.g. bill payments, cheque books) that constituted a service.

HMRC also argued that the existence of the exemption for retail banking activities in the Directive ("transactions, including negotiation, concerning deposit and current accounts, payments, transfers, debts, cheques") implied that they were within the scope of VAT but exempt. The judge agreed with the appellant that this did not logically follow: it was necessary to determine first whether a banking transaction constitutes a supply, and only then to consider whether the exemption applies.

Judge Mosedale also agreed with the appellant that a person who accepts a service provided to them (in this case, the bank accepting the supply of money by the depositor) does not necessarily make a supply of that mere acceptance. However, there could be a barter of services. The judge found that "*depositors could (subject to doing so in the right form) deposit and withdraw money at will; they were provided with an interface to give the bank instructions on withdrawals and deposits and could check their balance when they chose. Statements were provided. I consider that these*

facilities were valued by depositors." This constituted a service provided by the bank to the depositors, as it went well beyond what an ordinary debtor would provide to a lender.

The appellant's representative argued that there could be no consideration, as the bank's contracts emphasised that there were "no fees, no charges, no exceptions". If the judge found that there was consideration, this would amount to saying that the contract was a sham. The judge did not agree: the contract only said that there were no fees or charges, not that there was no consideration at all. The provision of the deposits was non-monetary consideration for the reciprocal supply of banking services.

The appellant's counsel went on to argue that the CJEU decision on *Kuwait Petroleum* (Case C-48/97) meant that the consideration could not be attached to the banking services.

122. The contract in Kuwait can be rendered diagrammatically as:

Cash for A + B

where A = petrol and B = vouchers for free gifts.

123. The contract in this case can be rendered diagrammatically, very similarly, as:

Non-cash (loan) for A + B

where A = interest and B = banking services

124. The judgment in Kuwait makes it clear that it is wrong, says Mr Prosser, to say that because contractually the supplier is bound to provide A + B in return for the consideration (whether cash or non-monetary), the consideration is necessarily 'for' both A + B in the VAT sense.

The judge distinguished the *Kuwait* case on the basis that the customers there only paid cash, rather than being engaged in barter. To her it was obvious that the bank supplied a service, and received consideration for it; the deposits were clearly valuable to the bank, and it was willing to pay interest (as well as incur considerable costs) in order to obtain them. An argument that the subjective value to the bank was "nil" was also rejected. The judge considered how it would be valued, and decided that it was possible (using the principles of *Empire Stores*) but unnecessary.

HMRC's argument that the "specified supplies" were non-economic activity were rejected – the holding of investments was "a direct, permanent and necessary extension" of its business. However, this did not help the appellant, because its inputs were directly linked to making exempt supplies in the UK, rather than being costs of the specified supplies. The appeal was dismissed.

The company appealed to the Upper Tribunal, which considered five separate issues.

The FTT had not made an error of law in concluding that the company made a supply to depositors. The judges set out their reasoning in detail, but broadly agreed with Judge Mosedale.

The FTT also made no error of law in deciding that the customers provided consideration for that supply. Counsel for the taxpayer argued that the situation was similar to *Kuwait*, in which customers paid only for petrol and gift vouchers were provided free; but the UT distinguished the

facts, holding that all customers of the bank used the banking services to some extent, if only to deposit and withdraw funds. There was no "optional extra" that could be regarded as provided free. There was a single consideration in "advancing credit", and distinct reciprocal consideration in "interest" and "services".

The UT examined the various possible ways of valuing the consideration and concluded that it would be difficult, but not impossible. It was not necessary to decide exactly how it should be done, only that it could be done. On the basis of these two conclusions – that there was a supply, and it was made for consideration – the appeal had to be dismissed.

The third question was whether, if it was not making supplies for consideration to the depositors, the bank could recover input tax on the account of an economic activity of making investments outside the EU. The UT examined the precedents in some detail, even though it was not necessary in order to determine the appeal, and concluded that it would have required further guidance from the CJEU in this area.

The fourth issue, attribution of inputs to the specified supplies, would have been difficult had the company succeeded on the first three, so the UT did not consider it in any detail.

The fifth issue was whether the company could benefit from reg.109 in respect of inputs that were incurred before the corporate reorganisation and used by one of the new companies afterwards. The UT considered that the regulation did not apply because some use had been made of the inputs before the merger; reg.109 only applies if there is a change of intention before the first use of the input.

The appeal was dismissed again.

Upper Tribunal: *ING Intermediate Holdings Ltd v HMRC*

5.3.2 Income outside the scope

The FTT decision in *Vehicle Control Services Ltd* (TC05196) appears to have been only published recently, even though the case was heard in late 2014. The appeal to the Upper Tribunal was heard in July 2016, so the publication of the two decisions appears closer together than the hearings actually were.

A company had been registered since 1990 in relation to the operation of car parks. Until 2012, the majority of its income came from penalty charge notices. In March 2013, the CA decided that PCN income was outside the scope of VAT. On 6 June 2013, the company submitted its VAT return for 04/13, claiming a repayment of £78,077. The return excluded £363,059 of PCN income that previously would have been treated as taxable.

HMRC refused the claim, ruling that there had to be an income-based apportionment between income within and outside the scope of VAT. They recalculated the recovery and repaid an interim amount, treating 92% of the input tax as non-business.

The company argued on the basis of *Kretztechnik* and *Church of England Children's Society* that the existence of non-business income should not restrict input tax recovery when there were only economic activities. However, it was conceded that the claim included VAT that was incurred

on expenses that only related to earning PCN income. The company accepted that this was non-deductible. However, this proportion was 31.2%, not 92%. If this attribution was not accepted as the appropriate basis, the company argued that the income-based apportionment was unfair, because costs were not incurred in proportion to the level of income. Other possibilities included time spent by employees on various activities, which would give a recovery of approximately 59%.

The judge noted a difference between the wording of VATA 1994 s.4 and the PVD. The VATA refers to a "taxable supply made by a taxable person in the course or furtherance of any business carried on by him", whereas the Directive refers to the supply of services, "effected for a consideration by a taxable person" and "taxable person" means a person who independently carries out any economic activity. The distinction is clearer in art.168, which only gives the right to deduct input tax on goods or services used for the purposes of the taxed transactions of a taxable person. The judge said that the UK law had to be interpreted in a manner consistent with the Directive.

In that light, he drew a distinction between:

(a) those costs which are attributable only to the generation of PCN income and which contribute nothing to VCS making taxable supplies and

(b) VCS's other inputs, comprising

(i) both those which are fully attributable to VCS's taxable supplies to its clients and

(ii) those, generally VCS's overheads, which are attributable both to the generation of PCN income and to making taxable supplies to clients.

The costs under (a) were not recoverable at all. Those under (b)(i) were recoverable in full but were relatively small. Those under (b)(ii) fell to be apportioned. The judge considered that an income-based apportionment was easily undertaken and readily verifiable. With some minor refinements, the judge arrived at the 8% recovery figure that HMRC started with.

The appeal was dismissed by the FTT, and the company appealed to the UT. The judges (Arnold J and Judge Walters) confirmed the decision below, agreeing that it was necessary to apportion VAT incurred in relation to transactions that were VATable and transactions that were outside the scope in much the same way as for exempt outputs. VAT on expenses was only deductible "to the extent that" it was used for taxable outputs. The appeal was dismissed again.

Upper Tribunal: *Vehicle Control Services Ltd v HMRC*

5.3.3 Toolkit

HMRC have updated their "partial exemption toolkit". This is intended for use by tax agents and advisers in preparing returns for clients, and also in reviewing their clients' systems for preparation of VAT returns to identify risks and help mitigate them. It is likely to be too detailed for practical use by most tax agents, but does represent an excellent training tool for understanding the preparation of returns and what can go wrong. These are likely to inform visiting officers who will look for the most

common errors in carrying out a routine compliance check (i.e. if they have not already identified some specific issue that they are following up).

It covers common errors arising from:

- failing to appreciate that there is a partial exemption issue
- errors of attribution and apportionment
- failure to make the appropriate annual adjustment, including the override
- operation of the capital goods scheme.

HMRC Toolkit: VAT Partial Exemption (2016)

5.4 Cars

5.4.1 Car purchase

A sole trader purchased a car for use in her business and deducted the input tax of £4,913. HMRC assessed to recover it and added a misdeclaration penalty of £736. This was the last outstanding issue in a dispute that had gone back to 07/06 and had originally involved £66,727 plus interest; it appears that HMRC had reduced all the other assessments to nil. The case had already been to the Upper Tribunal to obtain leave to appeal out of time.

There was an allegation that business records had been supplied to HMRC and lost. The insurance documentation in relation to the vehicle was included. The trader's accountant said that, following an earlier refusal of a claim for VAT on a vehicle, the trader had followed HMRC's advice on the purchase of this one and restricted the insurance to business use. The Tribunal decided that it was not appropriate, so long after the event, to insist that the trader should produce external evidence of this, and accepted the accountant's version as a fact.

The Tribunal was satisfied that if a taxpayer has, with the intention of satisfying the relevant condition, specifically arranged and maintained insurance cover which extends only to business use of the car (and has a settled intention to maintain that state of affairs throughout his or her period of ownership), then (following the suggestion to that effect made by Neuberger J in Upton), it is permissible for a Tribunal to make a finding of fact that the taxpayer had no intention, when acquiring the car, to make it available to any person, including himself (or herself), for personal use. On that basis, her appeal was allowed.

First-Tier Tribunal (TC05224): *Jane Borton t/a Contract Build*

5.4.2 Another car purchase

A trader claimed input tax credit of £7,833 on a Mercedes S350. HMRC refused the claim on the basis that they were not satisfied that there was no intention to make the car available for private use, and raised an assessment to recover the VAT that had been claimed.

The Tribunal noted the history of the car purchase. The company had used a number of vans to sell and service vending machines. The two

owners were a married couple who had fallen out and were in the process of an acrimonious divorce. The company had suffered financial difficulties after the 2008 recession, and was under special supervision by its bank. The purchase of a more prestigious car was undertaken to try to attract more blue chip customers. The company's accountant told the directors that it was difficult to justify VAT deduction on a car, but the following measures were taken:

(1) The vehicle was kept locked at the appellant's premises when not being used, including overnight. The premises comprised a unit with roller shutters on an industrial estate. Inside there was an area to keep stock and a small office area. At night the vehicle was kept inside the unit behind the roller shutters.

(2) The husband and wife were the only employees permitted to use the vehicle. Neither of them was to use it unless it was booked out for a meeting. The wife administered a booking facility for the vehicle in a desk diary which she maintained.

(3) The car keys were kept in the appellant's safe when the vehicle was not being used.

(4) A tracker was fitted to the vehicle in the same way as trackers were fitted to the appellant's vans. This meant that it was possible for both husband and wife to monitor use of the vehicle. It was also a security device in case the vehicle was stolen. The trackers were not a requirement of the insurance policy but had been installed in the vans to ensure that van drivers, who took the vans home at night and weekends, did not use them for private purposes.

On the other hand, the vehicle was added to the company's fleet policy, which insured for social, domestic and pleasure use as well as business use, and no formal board minute was recorded concerning restrictions on private use.

The appellants recreated a log of actual use from the booking diary, and HMRC did not question it. The Tribunal was satisfied that it was not actually used for any private purposes, which tended to support the appellant's case.

The judge considered the precedents of *Upton* and *Elm Milk Ltd*. He noted that in *Elm Milk*, there were formal legal restrictions on private use in the form of a board minute and inclusion in the terms of the director's employment contract. Although he noted the accountant's submission that it was unreasonable for a small company to be expected to have formal board minutes, he considered that the circumstances of the divorcing couple suggested that some formality, in particular some sanction for breach of the agreement that there would be no private use. The physical restrictions were not enough to make the car "not available". The appeal was dismissed, although the judge specifically noted that he accepted that the claim had been made in good faith.

First-Tier Tribunal (TC05321): *Venda Valet Ltd*

5.4.3 Yet more cars

A company appealed against an assessment for £27,151 raised to recover input tax claimed on a number of cars purchased between 11/10 and

02/13. Following an audit, HMRC formed the view that the company did not satisfy the conditions for input tax. The company, which provided groundwork services to building contractors, provided some evidence that the cars were kept on site or at its offices overnight, and employees' contracts of employment prohibited private use. HMRC did not accept this evidence.

The Tribunal was not satisfied that mileage logs provided by the company were necessarily reliable. The company's representative had led the witnesses, in spite of being told not to, to say that these logs were kept for income tax purposes. The Tribunal decided to disregard the logs in coming to its conclusion; they had been produced only after 2 years of HMRC insisting that they were the only possible way of justifying input tax deduction, covering a period going back 4 years, and the Financial Controller of the company said he was unaware of them.

The Tribunal considered the *Elm Milk* case in detail, and concluded that the proper legal test (not followed by HMRC) is that legal restrictions on private use are sufficient, particularly if supported by physical restrictions, to demonstrate that there is no intention to make a car available for private use. Mileage logs might be useful, but they are not essential.

The Tribunal also rejected an assertion by HMRC that private use would include buying cigarettes or lunch whilst out on a business journey, or even going off site to collect lunch. Such use must be entirely de minimis and was not to be regarded as non-business use at all. The Tribunal prepared the following comparison of the relevant factors in *Elm Milk* and the present case:

Elm Milk	*Zone*
Board resolution of a family company with sole director	No such resolution
No contract of employment for the director	Contracts of employment for all staff restricting private use
Office where car stored overnight and home 50 yards apart	Directors living some distance away from the office where cars were stored over night
No evidence of an alternative car	Both directors had alternative transport for commuting and private use
Insurance for private use and in the name of director and his family	Private use insurance for company employees only.

On the basis of the above comparison of the facts as presented to the Tribunal, following the full procedure for challenge of evidence, it appeared to the Tribunal that, if anything, the facts of the present case were stronger than those in *Elm Milk*.

Accordingly, the appeal was allowed.

First-Tier Tribunal (TC05330): *Zone Contractors Ltd*

5.5 Business entertainment

Nothing to report.

5.6 Non-business use of supplies

5.6.1 Pension fund management costs

Following the case of *PPG Holdings*, HMRC issued R&C Brief 43/2014 to announce a change of policy with regard to deduction of investment management charges incurred by employers in relation to their pension funds. The old treatment (allowing a 30% deduction where a combined bill was presented for administration and investment matters) was permitted to continue until 31 December 2015.

Discussions with interested parties revealed a number of difficulties in agreeing a new set of rules, so R&C Brief 17/2015 extended the transitional period to 31 December 2016. A further Brief has now extended it again to 31 December 2017. HMRC explain that "It's taking longer than expected to reconcile the court decision with pension and financial service regulations, accounting rules and emerging case law."

The Brief continues: "Some taxpayers may have already made changes to their structure and/or contractual arrangements to comply with the [PPG] judgment. Provided the employer and pension scheme trustees agree and both apply the same treatment, these taxpayers may continue with those arrangements. If they wish, they may choose to revert back to the previous treatment during the transitional period.

"The guidance that HMRC was intending to publish on possible options for recovery has currently been put on hold whilst we fully consider the wider implications of the options being proposed. In the meantime, VAT can be recovered on fund management costs in line with the guidance laid out in the previous R&C Briefs. Taxpayers are advised, however, that adopting alternative structures to comply with the VAT requirements could have wider implications, in particular in respect of regulatory requirements and Corporation Tax deductions."

Revenue & Customs Brief 14/2016

The previous Brief has been reissued with amendments to reflect the extension of the transitional period.

Revenue & Customs Brief 17/2015

5.7 Bad debt relief

5.7.1 Payment of debts?

A holding company claimed bad debt relief of £570,000 in respect of debts owed to it by a subsidiary that became insolvent. HMRC discovered that interest owed by the holding company to holders of loan notes had been written off, and decided that there was a sufficient connection between the writing off of the contract debt from the subsidiary and the

interest owed to the creditors that the creditors had effectively "paid" the debt. HMRC assessed to recover the bad debt relief.

The directors of the holding company had become concerned that the financial difficulties of the subsidiary would lead it to default on its own debt repayments to the loan note holders, potentially bringing down the entire group. They therefore approached the holders of the loan notes and asked for letters of comfort to confirm that payments could be deferred until a later date in order to prevent that default.

The lenders provided these letters, and wrote off interest totalling £3.665m during the financial year 30 September 2012. The subsidiary went into administration on 8 November 2012; the representative member claimed bad debt relief on debts of over £3.4m owed by the subsidiary to VAT-grouped companies in its 12/12 VAT return.

Initially HMRC accepted the claim, but in February 2014 an assessment was raised following a change of view. The officer relied on the 1993 case of *AEG (UK) Ltd*, in which a creditor had accepted shares in a debtor in satisfaction of the debt. Although the shares proved to be worthless, they were nevertheless consideration for the outstanding amount and ruled out a bad debt claim. The letters of comfort had included the wording: "*in my capacity as a loan note holder I confirm that any shortfall created by any amount due from [the subsidiary] will be satisfied (proportionally with other loan note holders) by accrued loan note interest being written off.*"

The appellant argued that repayment of bad debt relief was only required if "consideration for the supply" was received. That required a direct and immediate link between the payment and the supply. There was no such link between the write-off of the interest and the debts owing by the subsidiary. HMRC had interpreted the letters of comfort as a guarantee of the subsidiary's debts due to the other group companies, but this was not the case.

The Tribunal concluded that the letters of comfort could not be a contractual guarantee because they were gratuitous – no consideration was provided by the company to the lenders. The lenders entered into the arrangement to save the group as a whole and thereby preserve the residual value of their loans. There was therefore no direct link or reciprocal performance between the write-off and the supplies to the subsidiary. The *AEG* case was not relevant because the lenders in this case did not receive anything in exchange for the write-off.

The appeal was allowed.

First-Tier Tribunal (TC05279): *D Jacobson & Sons Ltd*

5.7.2 Cash accounting and BDR

A car servicing partnership fell seriously in arrears with its VAT returns. In 2015 it appointed a firm of accountants to try to bring its compliance up to date. The firm filed a return for 06/11 which included a bad debt relief claim of £30,681 in relation to supplies in the periods from 12/03 to 03/06, which had in 2006 been subject to an assessment. HMRC disallowed this claim as being made out of time.

The Tribunal described the situation as "not straightforward". The essence of the trader's argument was that the business had been entitled to use cash accounting in the period that had been subject to the assessment. If it had used cash accounting, it would not have been liable for output tax on work that was unbilled and unpaid. HMRC had never pointed out that there was a time limit on claiming bad debt relief. However, in 2006 they had pointed out that cash accounting would have prevented the assessment for output tax due on a "basic tax point" basis (work done), but the lack of an adequate cash book or similar record ruled out cash accounting.

The business had apparently routinely failed to bill or receive payment for jobs carried out. It claimed input tax on parts purchased, with the result that it regularly reclaimed VAT from HMRC on its VAT returns. It seemed that the trader intended to claim bad debt relief at some point, but the VAT affairs were so far in arrears that by the time the firm was able to do so, the time limit had expired.

The judge expressed sympathy for the trader, who had had to care for a sick mother over much of the period, but could not find any basis in law for claiming the BDR out of time. There was also no reasonable prospect of succeeding in a late appeal against the 2006 assessment. The appeal had to be dismissed.

First-Tier Tribunal (TC05342): *Thorne Motor Company*

5.8 Other input tax problems

5.8.1 Invoices issued to another

A trader claimed input tax on invoices raised showing the name of someone else. HMRC refused a claim for one period and raised an assessment to claw back input tax repaid in another. These decisions were originally taken in 2010, but only reached the Tribunal in 2016. A review had been requested by the trader's accountant in 2010 but, despite repeated reminders, had never been carried out. The judge noted that it was therefore "quite right" that HMRC did not object to an appeal being brought late.

The main issues related to invoices raised for rent and services charges issued in the name of "All In One Restaurants Ltd". The appellant had been a director of this company but it had never filed accounts and had been struck off. The Tribunal considered that these were in principle deductible under reg.29, because it appeared that the trader had personally discharged the costs and had incurred the rent for the purposes of the business. However, some of the cost was incurred over six months before the date of registration, so the appeal was allowed in part.

HMRC had disallowed the small invoices on the grounds that the trader had not produced evidence to show that they were incurred in relation to the business. This had not been put to the trader in correspondence, and the trader was not represented at the hearing. This put the judge in a difficult position, but he was inclined to accept on the balance of probabilities that the small amounts of input tax were deductible. This part of the appeal was also allowed.

First-Tier Tribunal (TC05347): *Vahid Alinejad*

5.8.2 Invoices

A trader claimed input tax of £39,152 on works to his warehouse. HMRC were concerned that the trader had not received taxable supplies from the companies shown on the invoices and disallowed the claim, adding a penalty for deliberate conduct of £20,555. This was reduced on appeal to £8,809 on the basis of careless but not deliberate conduct.

The Tribunal considered the evidence, which included the fact that the two companies that had raised the invoices had never declared any output tax. The invoices presented to the investigating officer contained a number of misspellings and anomalies, and did not comply with reg.14 in several respects, including the generality of the descriptions.

The Tribunal considered the reasonableness of the officer's refusal to accept alternative evidence based on credit card payments and the trader's claims that he had used borrowed cash. The Tribunal was satisfied that the decision was reasonable based on the information available at the time, and the Tribunal would have reached the same decision, even with the benefit of the much greater amount of information that had been presented to it. It was possible that the supplies had been made by an individual who had claimed to represent the two building companies, but did not in fact do so. There was therefore insufficient evidence to show that the trader had paid input tax on supplies received.

The Tribunal did not accept the taxpayer's argument that the behaviour was not careless. The poor state of his records justified a finding of carelessness. 50% mitigation of a prompted disclosure, leaving a penalty at 22.5% of the PLR, was confirmed. The judge also decided not to order HMRC to suspend the penalty, because the deficiencies were serious and the judge was not satisfied that the suggested conditions would help the trader avoid future careless inaccuracies.

All the appeals were dismissed.

First-Tier Tribunal (TC05376): *Gurcharan Singh t/a Smethwick Carpet & Furniture Warehouse*

5.8.3 Missing traders

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

The FTT (TC04449) considered that one of the 115 transactions was not shown to be connected to a fraudulent tax loss – it did not fit into the same pattern of supply chains as the others. However, the rest were so connected, and the deals had the normal features of MTIC transactions: suppliers and customers were known to each other, so the insertion of the appellant into the chain appeared to serve no commercial purpose or logic other than to generate VAT repayments. The only reasonable explanation was that the director knew of the connection. If he did not know, he should have known.

The company appealed to the UT, arguing that the FTT had come to conclusions on points that had not been argued before it, and had applied the wrong tests and had therefore come to an unjustifiable conclusion on "knowledge and means of knowledge". The Upper Tribunal (Arnold J and Judge Hellier) examined the various complaints in detail and rejected them all. The FTT had produced a carefully reasoned decision and was entitled to come to all the conclusions it had drawn. The appeal was dismissed.

Upper Tribunal: *Ulster Metal Refiners v HMRC*

A company appealed against refusal of input tax claims for £767,000 and £1.367m for the periods 03/06 and 06/06. The decision is interesting for the reproduction of long sections of cross-examination of the main witness. The normal conclusion was drawn: the director knew, and had the means of knowing, that the transactions were connected with fraud. The appeal was dismissed.

First-Tier Tribunal (TC05202): *Leeds Smith Consulting Ltd*

A company appealed against refusal of a total of nearly £20.9m of input tax for periods from 07/06 to 12/10. It had been to the Tribunals several times over the years (including under its previous name, Enta Technologies Ltd) on procedural matters. The eventual substantive hearing took place over 8 days at the end of 2014, but the decision has only just been published. The usual detailed examination of the deals and business practices led to the usual conclusion, and the appeals were dismissed.

First-Tier Tribunal (TC05226): *Changtel Solutions UK Ltd*

A rare victory for the taxpayer in the FTT (TC04239) has been reversed in the UT. It was agreed by both parties that deal chains had resulted in a fraudulent tax loss. The company was denied input tax of £428,525 in respect of the purchase of computer equipment in the period 09/06.

The FTT (Judge Shipwright and Ms Susan Lousada) noted that the parties had applied to put their closing submissions in writing. HMRC's closing submission was "about 116 pages. It was wide ranging and much of it did not go to the essential issue in this case namely whether the test in *Mobilx* that the only reasonable explanation for the transaction in which the taxpayer was involved was connected to fraud bearing in mind the taxpayer's knowledge at the relevant time was satisfied. Much of it related to matters which were outside HMRC's knowledge let alone the Taxpayer's knowledge at the time in question. Much of it was not of assistance to the Tribunal. The Tribunal reread the document carefully a number of times before reaching this conclusion."

By contrast, the appellant's response was "to the point, of a sensible length and within time" – it was described as "helpful", which pointedly contrasted with the HMRC submission. HMRC then issued further submissions; as the appellant normally has "the last word", the taxpayer objected. The Tribunal issued directions allowing HMRC's further submissions as long as the taxpayer could respond to them again. Their document was submitted in accordance with the direction, and "At eight pages these were considerably more focussed and of greater utility than the somewhat unfocused HMRC document."

The FTT clearly preferred the taxpayer's witnesses to those provided by HMRC. The decision included several assertions that were disproved by evidence – for example, that the company did not issue terms and conditions to its customers, when these were printed on the back of the order forms. The HMRC officer who issued the decision appears to have discovered this during the hearing.

Overall, the FTT did not accept that HMRC had satisfied the burden of proof to show either than the company knew of the fraud, or had the means of knowing. The appeal was allowed, and the company was invited to apply for costs.

HMRC appealed to the Upper Tribunal, arguing that the FTT had failed to apply the correct test in relation to proving the company's state of knowledge. The FTT had given little weight to evidence of witnesses who had not been cross-examined, even though it had been agreed that they would not need to be. It had not given full and proper reasons for its decision, and had refused to draw adverse inferences from the company's failure to provide witness statements from relevant witnesses without adequate reasons. Overall, the FTT had failed to consider the circumstances in the round, as required by the Court of Appeal's judgment in *Mobilx*.

The UT examined the decision in detail, and broadly agreed with all of HMRC's criticisms of it. The decision was set aside and the case remitted to a differently constituted First-Tier Tribunal for rehearing in its entirety.

Upper Tribunal: *HMRC v Pacific Computers Ltd*

A company appealed against decisions to refuse repayments totalling £1.8m in relation to (unusually) 3 quarterly return periods (12/05, 03/06 and 06/06). The appeal proceedings had been particularly tortuous, including an application by the appellant to have the judge "recused". This was turned down, and in the end the original judge concluded that the company's witnesses were not credible: "*The discrepancies and anomalies within the individual deals were significant, and the failures of Mr Andrews and Mr Case to act on those discrepancies undermined their assertions that they were involved in the bona fide trading of mobile phones.*" The FTT (TC03380) was satisfied that they knew that their transactions were connected with fraud; it was therefore not necessary to consider the alternative test, but for completeness the FTT also concluded that they should have known.

The company appealed to the Upper Tribunal (Morgan J and Judge Bishopp). They examined a number of criticisms of the FTT decision and found no reason to overturn it. The appeal was dismissed again.

Upper Tribunal: *Tricor plc v HMRC*

5.8.4 Toolkit

HMRC have updated their "input tax toolkit". This is intended for use by tax agents and advisers in preparing returns for clients, and also in reviewing their clients' systems for preparation of VAT returns to identify risks and help mitigate them. It is likely to be too detailed for practical use by most tax agents, but does represent an excellent training tool for understanding the preparation of returns and what can go wrong. These are likely to inform visiting officers who will look for the most common

errors in carrying out a routine compliance check (i.e. if they have not already identified some specific issue that they are following up).

It covers in particular:

- Reclaiming VAT on purchases made before registration or after deregistration
- Flat Rate Scheme
- Areas of risk within VAT input tax
- Checklist for VAT input tax
- Explanation and mitigation of risks

It gives the following list of common errors:

- duplicated claims – particularly where requests for payment or pro-forma invoices have been received
- manual, arithmetical and consolidation errors
- input tax incorrectly calculated on VAT inclusive amounts
- VAT and net values transposed
- input tax incorrectly calculated for VAT reduced rate purchases or transactions subject to a settlement discount
- input tax claimed on purchases which do not carry VAT (such as stamps, train/air/bus tickets, some tolls)
- input tax claimed on costs incurred outside the UK (for example conference/business trip accommodation and meals)
- Insurance Premium Tax (IPT) claimed as input tax
- VAT Return and assessment payments claimed as input tax
- purchase credit notes incorrectly posted
- self-billed sales invoices on which output tax is due posted as purchase invoices
- input tax claimed on costs proper to a third party.

HMRC Toolkit: VAT Input Tax (2016)

5.8.5 Articles

In an article in *Taxation*, Neil Warren comments on cases in which purchasers have paid a deposit and then been denied input tax because the supply is never made (most recently, *D&J Grant* (TC05195)).

Taxation, 21 July 2016

In another article in *Taxation*, Neil Warren describes the problem of a trader buying a business and mistakenly paying VAT, where the seller fails to account for the output tax and HMRC apply the TOGC rule.

Taxation, 14 September 2016

6. ADMINISTRATION AND PENALTIES

6.1 Group registration

Nothing to report.

6.2 Other registration rules

6.2.1 Updated Notices

HMRC have updated their Notice *Cancelling your registration*. It nowprovides more detailed information on how to cancel a VAT registration using the online service. The associated supplement updates the VAT registration and deregistration thresholds as announced in Budget 2016.

Notice 700/11

HMRC have updated their Notice *Should I be registered for VAT?* to reflect the introduction of new powers which enable HMRC to hold an online marketplace jointly and severally liable for the unpaid VAT of an overseas seller that is trading goods in the UK via that online marketplace, and the power to direct some non-established taxable persons (NETPs) to appoint a VAT representative who is based in the UK.

Notice 700/1

6.3 Payments and returns

6.3.1 Flat rate scheme

A company registered for VAT on 16 June 2008 and applied for the FRS. The trader stated that the main activity was “project management”, and used the rate of 12.5% current for “architect, civil or structural engineer”. This appeared to be in accordance with Notice 733, which at the time advised engineering consultants and designers to use this rate. The rate for “other activities not listed elsewhere” was 10%.

On 27 October 2015 his accountants wrote to HMRC, stating that the case of *Idess Ltd* showed that this was an incorrect classification. VAT overpaid for the last four years was reclaimed. HMRC accepted that the “other activities” rate could be used from 1 September 2015, but refused to backdate the change because the original choice was “reasonable”.

The judge noted that the appeal law within VATA 1994 s.84(4ZA)(a), which meant that he could only find for the appellant if he was satisfied that HMRC could not have reasonably come to their decision. The Tribunal agreed with the appellant that the officer had failed to take relevant matters into account (the *Idess* decision and the wording of the regulation) and had taken irrelevant matters into account (asserting that revising the liability later would be contrary to the simplification objectives of the FRS, when the trader was not asking to file returns on a different basis).

The judge also commented on some unusual features of the case, including the fact that a review had been requested and granted, but apparently not completed (the appeal was against the original decision, with no review decision in the bundle). He also noted that it was not clear why the accountants had asked for permission to change the rate, when there is nothing in the regulations that suggests HMRC have a specific power to authorise the rate itself. If they disagree with the rate used, they can carry out a compliance check and raise an assessment; if the trader wants to change the rate retrospectively, as here, the trader can make a repayment claim and HMRC can refuse it.

The trader's appeal was allowed on the basis that the dispute had been agreed between the parties to be about HMRC's refusal to authorise the rate, whether or not that was correct in law.

First-Tier Tribunal (TC05351): *JJK Engineering Ltd*

6.3.2 Flat rate farmers

It is rare for any appeal to feature the agricultural flat-rate scheme (AFRS). HMRC decided to cancel a farmer's AFRS registration for the protection of the revenue. The trader appealed, arguing that HMRC had no power to do that.

In the FTT (TC04057), HMRC put forward figures showing that the trader was enjoying a large and increasing benefit under the AFRS. In the year to 30/6/2012, HMRC calculated that it had benefited by nearly £137,000. It had lost out because of capital works on the farm in the years to 06/07 and 06/08, but overall it was making a great deal of money, and the amount was increasing year by year.

The FTT held that the ability of HMRC to exclude a trader from the AFRS was clearly in accordance with the PVD, which gave Member States leeway to design their own schemes but required them to restrict the benefit to the amount of input tax that would otherwise be claimed. The size and nature of this appellant's business was such that it obtained a financial benefit that could not be reconciled with fiscal neutrality.

The FTT declined to refer a question to the CJEU because, in the opinion of the judge, the answer was obvious.

The trader appealed to the Upper Tribunal, where Mr Justice Nugee was less confident about the answer. He decided that it was appropriate to refer questions. After lengthy consideration and quotation of the law and the FTT decision, the judge summarised the contentions of the taxpayer as:

- The "exclusivity issue": whether Article 296.2, which permits a Member State to exclude from the scheme "certain categories of farmers", provides an exclusive regime as to when persons can be excluded from the common flat rate scheme.
- The "categories issue": whether the exclusion of Shields from the scheme can be said to be, or result from, the exclusion of a category within the meaning of Article 296.2.

The taxpayer's counsel cited *Zita Modes* as an example of the exclusivity issue: member states had discretion on whether to introduce a TOGC rule, but if they introduced one, they could only do so within the parameters set

down by the PVD. He identified four different "tools" set down by the PVD for the regulation of the AFRS, which he argued were comprehensive. Member states did not have a general discretion to exclude particular farmers from the scheme for reasons other than those given.

HMRC responded that the PVD required the scheme to be operated in accordance with the principle of fiscal neutrality, and the UK's rules were in line with that.

On the "categories" issue, the taxpayer's counsel argued that the law allowed for the exclusion of "groups" of farmers, but not individual farmers as in this case. HMRC responded that the "group" was "farmers who are found to be recovering substantially more as a member of the Flat Rate Scheme than they would if they were registered for VAT in the usual way", and this individual farmer was a member of that group.

The judge decided that there was insufficient precedent to answer either question with certainty, so he invited the parties to submit suggestions for the order for reference.

Upper Tribunal: *Shields & Sons Partnership v HMRC*

The questions have now been published:

With regard to the common flat-rate scheme for farmers which is established by Chapter 2 of Title XII of Council Directive (EC) 2006/112/EC, is Article 296(2) to be interpreted as providing an exhaustive regime as to when a Member State is able to exclude a farmer from the common agricultural flat-rate scheme? In particular:

- Is a Member State only able to exclude farmers from the common flat-rate scheme for farmers pursuant to Article 296(2)?
- Is a Member State also able to exclude a farmer from the common flat-rate scheme for farmers using Article 299?
- Does the principle of fiscal neutrality give a Member State a right to exclude a farmer from the common flat-rate scheme for farmers?
- Do Member States have an entitlement to exclude farmers from the common flat-rate scheme for farmers on any other grounds?

How is the term "categories of farmers" in Article 296(2) of Council Directive (EC) 2006/112/EC to be interpreted? In particular:

- Must a relevant category of farmers be capable of being identified by reference to objective characteristics?
- Can a relevant category of farmers be capable of being identified by reference to economic considerations?
- What level of precision is required in identifying a category of farmers which a Member State has purported to exclude?
- Does it entitle a Member State to treat as a relevant category "farmers who are found to be recovering substantially more as members of the flat-rate scheme than they would if they were registered for VAT"?

CJEU (Reference) (Case C-262/16): *Shields & Sons Partnership v HMRC*

6.4 Repayment claims

6.4.1 Who claims a repayment?

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

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

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

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

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

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

was incorrectly made to T, and confirmed further that C was the company entitled to repayment.

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

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

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

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

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

The company appealed to the Court of Session. The essential issue before the court was whether the claim made by C could be regarded as made on behalf of the representative member of its former VAT group, T. If so, T was entitled to the repayment; if not, no one would be entitled to it.

The court considered that the contents of the correspondence between C and HMRC, as well as the statutory scheme of s.43 VATA 1994, supported the company's contention. C had quoted T's VAT number and name on some of its claims, and HMRC had clearly regarded the claim as made on T's behalf as they paid the money to T. Claims could be made by tax advisers on behalf of clients; there was no reason why a subsidiary should not make a claim on behalf of the representative member.

Everything done by a member of the group was regarded as done by the representative member, and this was a mere extension of that statutory principle.

The court confirmed that C was not entitled to the repayment. T had been responsible for paying the VAT in the period for which the repayment was claimed, and only T had therefore overpaid VAT. T was entitled to regard the timely claims made by C as made on its behalf, and it was entitled to the repayment. Its appeal was allowed.

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

6.5 Timing issues

Nothing to report.

6.6 Records

Nothing to report.

6.7 Assessments

6.7.1 Best judgement

A trader took over a run-down cafe and built up its business over the next few years, putting in more tables and starting to sell takeaway pizzas. At an unannounced visit in 2012, two officers formed the view that the trader was zero-rating far more of his sales than he should be. Further enquiries suggested that there was also suppression of takings. Best judgement assessments were raised, extrapolating two days' observations back over four years. The amount was £28,436.

The trader appealed, mainly arguing that the extrapolation was unreasonable and that insufficient allowance had been made for changes to the business during the period. The Tribunal was satisfied that the officers had taken into account the trader's explanations of the development of the business, and the assessment was made to best judgement. The trader did not discharge the burden of displacing the assessments. His appeal was dismissed.

First-Tier Tribunal (TC05266): *Seyed Anayet Torkizadeh and Homeira Torkizadeh*

HMRC assessed a fish and chip shop owner to £28,323 of VAT and a penalty of £26,913 (95%) in respect of underdeclared takings. The Tribunal examined the evidence and the arguments put forward by both sides, and was satisfied that the assessment was made to the best of the officer's judgement. There was no reason to disturb the quantum. It was also clear that there had been deliberate behaviour with concealment and

very little cooperation, so the appeals against both the assessment and the penalty were dismissed.

First-Tier Tribunal (TC05332): *Kyriakos Karoulla t/a Brockley's Rock*

6.7.2 Time limits

A newsagent was assessed in respect of undeclared income for periods from 2002 to 2009. The totals were £116,706 in income tax and £25,653 in VAT. There were also penalties for dishonest evasion of VAT at 90% of the sum assessed. The assessments were raised in 2011, but the appeal only reached the Tribunal in January 2016.

The main objections to the assessments were on procedural grounds relating to time limits and the presentation of the information. In particular, HMRC had relied on the 20-year time limit for dishonesty, and periods outside the normal assessing time limit were grouped together in the assessment and penalty assessment and referred to as "period 00/00". The trader's representative tried to undermine the validity of the assessment on this basis, but the judge disagreed. It was clear from the accompanying correspondence what was being assessed, and the assessment taken as a whole was in time and properly notified. The appeals against all the assessments were dismissed.

First-Tier Tribunal (TC05293): *Mohammad Amin*

6.7.3 Dishonesty and a TOGC

HMRC assessed a restaurant operator for underdeclared VAT from 03/08 to 12/12, and penalties under s.60 and Sch.24 FA 2007 for the periods either side of 1 April 2009 when the rules changed. The Tribunal also heard appeals against income tax assessments for the years 2009/10 to 2011/12 relating to the same investigation.

The owner had originally run the restaurant as a sole proprietor, but had transferred it to a company in October 2011. Part of the appeal concerned the relevance of that transfer for the identity of the person liable to pay back taxes. The Tribunal observed that VATA 1994 s.49 specifically excludes the transfer of penalties under s.59 to s.70 to a successor; after consideration, HMRC withdrew the penalties for the periods up to the TOGC entirely. This included the Sch.24 penalties, even though they were not referred to in s.49. They reserved the right to assess these penalties on the individual, to the extent that they were still within the relevant time limits.

The judge considered the competing arguments of HMRC and the trader, who maintained that he had done nothing wrong. HMRC's version was believed, but with three adjustments:

(1) The adjusted sales should be calculated assuming that cash sales represent 40% (rather than 50%) of total turnover;

(2) The adjusted profits should be calculated after a 35% (rather than nil) deduction for costs and expenses; and

(3) The penalties (for both Mr Ali and the Company) should be calculated at 49% (rather than 54.25%) of the inaccuracies, to give greater mitigation for "helping" (even though Mr Ali had consistently denied the inaccuracies).

To that extent, the appeals were allowed, but the assessments to both VAT and income tax, and the deliberate conduct penalties, were all upheld in principle.

First-Tier Tribunal (TC05327): *Balti Hut (Gloucester) Ltd; Abdul Ghane Ali*

6.7.4 More best judgement

A trader appealed against assessments for £19,657 in respect of periods from 05/08 to 02/11 and £5,026 for periods 11/09 to 08/10. He also sought to appeal against further assessments for £54,721 for periods from 05/11 to 05/13; however, as he had not submitted returns for those periods, the Tribunal had no jurisdiction to hear an appeal against assessments.

The trader had not provided any evidence to displace the assessment. There was some question about the accuracy of a particular figure in the calculations, and the trader was given a final opportunity to show that it was wrong; if he could not do so within 14 days, the appeal would be dismissed.

First-Tier Tribunal (TC05371): *Mehmooda Sultana Khan t/a Café Aroma*

6.8 Penalties and appeals

6.8.1 Default surcharges

HMRC published the new VAT Default Surcharge Officer's Guide on 26 August 2016, which supplements the guidance in VAT Notice 700/50. Accordingly, the default surcharge section has been removed from the VAT Civil Penalties manual.

The new guidance is not long or detailed. It includes some information about when DS is routinely inhibited, and also notes that the purpose of DS is to improve compliance. There is still no indication of any implementation of the FA 2009 regime of penalising late returns and payments, or any response to the consultation on reform of penalties carried out in the first half of 2015.

www.gov.uk/hmrc-internal-manuals/vat-default-surcharge-officers-guide

HMRC have updated their Notice *Default surcharge*, replacing the July 2013 version. There is no "What's changed" section, so it is hard to identify what required updating. The content is in line with the policies regularly applied in appeals.

Notice 700/50

In an article in *Taxation*, Mike Thexton expresses the view that the default surcharge system is unduly harsh and should be changed to something more proportionate, concentrating in particular on the case of *Posnett* (TC05306) described below.

Taxation, 29 September 2016

A company appealed against a 10% surcharge of £1,136 for the period 08/15. The appeal was dealt with on paper without a hearing. The various reasons for late payment (by one day) were not enough to be a

reasonable excuse: the company had been warned, and should have taken steps to avoid another late payment.

First-Tier Tribunal (TC05213): *Ad Hoc Wine Bars Ltd*

A company appealed against a 2% surcharge of £1,667 for the period 07/15. The return was filed on 7 September, and the payments were received in three instalments on 8 September, one day late. The appeal was dealt with on paper. The problem was that the bank had set a limit of £25,000 on individual transfers by Faster Payments. In earlier quarters, this had been £50,000, but was then reduced; the company had asked the bank to put it back up, but this had not been done. Because the company had requested an excessive payment (£50,000) on 7 September, its second request (£33,372) on the same day was put in pending and could not be processed until the following day. The limit only applied to individual transactions, not to daily totals. There was sufficient money in the account to settle the whole bill.

HMRC said that the trader should have checked that the limits had been increased. However, the judge held that the trader had acted competently and reasonably in the circumstances, and the late payment was due to the bank's error, which the bank had admitted. The appeal was allowed.

First-Tier Tribunal (TC05214): *Pyments Alcester Ltd*

A sole trader appealed against a 15% surcharge of £446 levied for her 02/15 period. She was a criminal barrister, and she presented (in correspondence – again, there was no hearing) a robust criticism of HMRC's conduct. However, the Tribunal was satisfied that she did (contrary to her claims) have a history of late returns and payments, and no reasonable excuse. The return in question was 22 days late, resulting in very late collection of the direct debit. The 2% and 5% surcharges had been below the £400 threshold, and the 10% surcharge amounted only to the statutory minimum of £30; however, she was warned at that time that further late payments would incur a 15% surcharge. Her appeal was dismissed.

The Tribunal judge (Peter Sheppard) noted that her correspondence referred to further surcharges for later periods. He observed that, if she wished to appeal against these, it would be helpful if she used the correct forms and set out her grounds of appeal (and the surcharges appealed against) more clearly.

First-Tier Tribunal (TC05232): *Alexia Zimbler*

A company appealed against a 2% surcharge of £732 levied for its 08/15 period. The appeal was determined on paper. The director suggested that paying 2 days late in a commercial environment would be "a perfectly acceptable practice and only attract interest plus a late payment fee". He also noted that the payment was a day earlier than it would have been if made by direct debit, and claimed that the company had "received no warning". The Tribunal rejected all these contentions – in particular, there was no evidence that the surcharge liability notice had not been received. The appeal was dismissed.

First-Tier Tribunal (TC05239): *Rossway Ltd*

A company appealed against a 10% surcharge of £5,410 levied for its 11/12 period. There was a hearing but the taxpayer was not represented.

The return was on time, but the payment was made in five instalments from 13 February 2013 to 5 April 2013, all of them late. The company had been in default for all the periods in 2012, with increasing levels of surcharge being levied.

The company's representatives appealed on the grounds that the directors had applied to the bank for additional funding, but administrative delays had meant that the funds were not available. The quarter to 11/12 had seen a "spike" in turnover that meant the liability was considerably higher than usual.

There was considerable delay and some confusion in the correspondence over the next three years before a formal appeal was lodged. The trader's grounds for appeal were that HMRC had misunderstood the original arguments in relation to the review: they had not pleaded lack of funds, but bank error. Some of the grounds that were eventually put before the Tribunal in relation to the 11/12 default were in fact more relevant to a later period, 05/13.

The judge considered the circumstances, including the habitual defaults over the preceding year, and concluded that the trader had not shown, on the balance of probabilities, that there was anything that would constitute a reasonable excuse for the period 11/12. The appeal was dismissed.

First-Tier Tribunal (TC05240): *Sun Hill Racing Ltd*

A company appealed against a 10% surcharge of £1,308 levied for its 06/14 period. The appeal was determined on paper. The company had defaulted in all the preceding five periods. The payment was one day late. The company offered a number of difficulties as reasons for late payment, but in the context, none was a reasonable excuse. A prudent and diligent taxpayer would have taken account of the warnings issued and would have at least contacted HMRC before the due date. The appeal was dismissed.

First-Tier Tribunal (TC05244): *First Testing Ltd*

A sole trader appealed against a series of surcharges for the periods 08/13 to 08/14 totalling £4,195. The Tribunal did not accept that she had a reasonable excuse for these periods, but allowed an excuse for an earlier period, which reduced these surcharges to £2,281.

The trader had failed to pay the set payments on account (£3,150) under annual accounting. She had instead made irregular payments of £3,000 when she had the funds available, which meant she often missed the due date. She failed to read carefully the letters telling her that this would lead to her removal from the annual accounting scheme, simply filing the letters to be dealt with when she completed her annual return. She therefore failed to realise that she had been put onto quarterly returns from the period to 05/13. She failed to notice that a return sent to her covered the period 1/4/12 to 28/2/13, a final 11-month period before being returned to quarterly periods; she assumed it was her usual annual return.

She then filed and did not read surcharge liability notices and estimated assessments for the next few periods. She did not contact HMRC until January 2014, when her accountants asked her to confirm the amount of VAT due. She then discovered that she was seriously in arrears. Her accounting system was not geared up to produce quarterly figures, so the outstanding returns were not provided until June 2014.

The judge considered that, on the balance of probabilities, she had not received the first letter telling her that she had been removed from annual accounting. There were other letters that she had received and admitted that she had not properly read; this letter was not in her files at all. Having decided that, the judge concluded that she had a reasonable excuse for late filing and payment of the long period return to 02/13, and all the subsequent surcharges should be recalculated on the basis that the 05/13 return was the first default. Her appeal was allowed to that extent.

First-Tier Tribunal (TC05256): *Angela Spence t/a Spence and Horne Solicitors*

A company appealed against a 10% surcharge of £821 levied for its 07/15 period. The payment was a day late. There were a number of mitigating factors, including the book-keeper going on holiday, the recent death of the director's mother and his involvement in dealing with his aunt's estate. Although the judge had some sympathy, he did not consider that any of these could constitute a reasonable excuse.

First-Tier Tribunal (TC05259): *GM Polystyrene Ltd*

A company appealed against a 10% surcharge of £571 levied for its 11/15 period. The company had filed the return on time and believed that a direct debit was in place; the fact that it was not effective was missed during the handover from one tax agent to another. Even so, the new agents advised the company to make the payment, which it did by 11 January – a day earlier than the direct debit would have arrived.

The Tribunal acknowledged that the trader was trying to put its tax affairs in order. However, in handing over to a new agent it should have disclosed the letters about surcharge liability from HMRC. The warnings had not been heeded, and the appeal was dismissed.

First-Tier Tribunal (TC05262): *Pro-Scaffolding (South West) Ltd*

A company appealed against a 5% surcharge of £3,220 levied for its 11/15 period. The appeal was settled on paper. The Tribunal noted that the company's explanations in correspondence were unclear – there were references to the need for a director to be present to sign a cheque, even though payments were made by direct debit. It did not appear that the company had put forward any circumstances that were unforeseeable or beyond the company's control. The appeal was dismissed.

First-Tier Tribunal (TC05263): *Innzone Ltd*

A company appealed against a 2% surcharge of £600 levied for its 07/15 period. The appeal was settled on paper. The company had paid its VAT in three instalments on 7, 8 and 9 September, because it had a £20,000 daily limit on Faster Payments. The grounds for appeal were that the company had rung the Advice Line on 7 September and explained this, and had not been told that there would be a surcharge. HMRC had no record of the call and the company provided no evidence in the form of an itemised phone bill, in spite of claiming that they had been "on hold" for 23 minutes.

The Tribunal considered the failure to provide this evidence was fatal to the appeal. There was nothing to substantiate a reasonable excuse. The liability for a previous period had also had to be paid by instalments, which suggested that the trader should have known about the daily limit

and should have made plans for payment earlier. The appeal was dismissed.

First-Tier Tribunal (TC05264): *BPL (Global) Ltd*

A company appealed against a surcharge of £490 for its 12/05 period. The case was settled on paper. The trader's accountant wrote in support of the appeal, stating that he had rung to negotiate a two-week extension on 5 February (2 days before the due date) but the line had continually gone dead. He had tried again repeatedly but only managed to get through on 12 February, when HMRC agreed the extension, which the trader complied with. The trader had expected to be able to pay on time, but late payment by a debtor meant that he had an unexpected problem.

The trader's history of defaults was examined by the Tribunal. He appeared always to file the return on time, but had been 1 day late paying in 06/14, which led to the issue of a SLN; he was 2 days late paying in 12/14, when the 2% surcharge was too small to collect; and he was 2 days late paying for 09/15, with the 5% surcharge still below the limit.

HMRC argued that the appellant and their agent should have been aware that there was a strong likelihood that there would be a large volume of calls being made to the respondents on the days immediately prior to the due date and that as a result the appellant and agent could reasonably have expected delays in being able to make contact. The Tribunal did not accept this. The taxpayer and his agent, faced with the unexpected late receipt, had done all that they reasonably could in the circumstances. The judge considered that the unexpected inability to make a TTP arrangement before the due date was a reasonable excuse, and allowed the appeal.

First-Tier Tribunal (TC05278): *McNamara Joinery Ltd*

A sole trader appealed against surcharges totalling £5,590 for a total of 18 periods. He owned the business, but it was run by his then partner, who prepared the VAT returns. The appeal was dismissed and the time limit for applying for a fully reasoned decision passed; a late application for such a decision was considered and accepted, in spite of a serious breach of the time limit, because the accountants claimed that the Tribunal had sent correspondence to an out-of-date address.

The Tribunal dismissed the appeal because the trader did not even offer a reasonable excuse. He argued that the responsibility was that of his partner, but he could not deny that he had the legal ownership and he had not put in place any procedures to make sure that the VAT liabilities of the business were paid on time.

First-Tier Tribunal (TC05280): *Ray Yates*

A company appealed against surcharges for its periods 06/13, 12/13 and 03/14, calculated at 2%, 5% and 10%. The total was £5,454. All the returns were filed on time, but the payments were late. The company had been owed £41,000 for CIS deductions for the 2012/13 tax year that was only repaid on 20/11/2013; HMRC also owed £90,000 in respect of 2013/14, but that was repaid promptly on 27/04/2014.

HMRC had no record of TTP being requested before the due dates. When the late payment for 03/13 was discussed with a director, she did not raise the issue of money owing from HMRC; rather she apologised for the payment being overlooked.

The Tribunal noted the decision in *Paul Raymond Marsh* (VTD 20,091) in which outstanding CIS repayments had been held to be a reasonable excuse for shortage of funds. This was an excuse for 06/13. However, there was no such excuse for 12/13 or 03/14; the CIS repayments in respect of that tax year were paid as soon as they could be. The rate of surcharge was reduced from 5% to 2% and from 10% to 5%, reducing the total charges to £1,397.

First-Tier Tribunal (TC05284): *SOS Joinery Ltd*

A payments on account trader appealed against a surcharge of £13,364 charged at 2% in respect of its balancing payment for the 03/15 period, which was received 1 day late on 1 May 2015. The company argued either that there was a reasonable excuse for the default in the 06/14 period, which would remove the liability, or the penalty for 03/14 was disproportionate.

The company had entered the POA regime in the 06/14 period. HMRC had sent a notice to that effect on 7 April 2014 after the company had exceeded the £2.3m threshold in the four quarters to December 2013. The letter set out the due dates for the payments and stated that the normal 7-day extension was not available to POA traders. The company's director stated in evidence that he had consulted the HMRC website and found reference to the 7-day extension, without any exception being mentioned for POA traders. The balance was therefore paid on 7 August 2014. The director argued that the "small print" and the inconsistencies in HMRC's information constituted a reasonable excuse.

The Tribunal did not agree. Specific instructions had been provided to the company. It had no reasonable excuse for late payment in 06/14, and as it accepted it had no reasonable excuse for 03/15 (the instruction to the bank had been given too late in the day on 30 April for a same day transfer), its appeal had to be dismissed. The judge considered the disproportionality argument and came to the usual conclusion: this was not a wholly exceptional case.

First-Tier Tribunal (TC05289): *Dennison Trailers Ltd*

A company appealed against surcharges for the periods 12/13, 06/14, 09/14 and 12/14. Surcharges for 03/13 and 09/13 were below the £400 threshold; those following were at 10% and 15%. The total was £3,750. The trader claimed not to have received the SLNs and SLNEs because he had moved. HMRC said they had properly served the notices by post to the address on their system; the director had not notified them of the change of address at the proper time. He claimed to have put in place forwarding arrangements with Royal Mail, but unfortunately he had not included his company as a "resident" within these arrangements. It was therefore possible that letters addressed to the company would not have been forwarded. In this circumstance, he might not have seen the letters, but that was his fault rather than that of HMRC. The notices had been served. The director's other circumstances did not constitute a reasonable excuse. The appeal was dismissed.

First-Tier Tribunal (TC05298): *PN & MMA Consultants Ltd*

A company appealed against a 5% surcharge of £510 levied for its 10/15 period. The appeal was settled on paper. The return was filed on 30 November, in the mistaken belief that a direct debit was in place for the

payment. As it was not, the payment was not made until 21 December after a reminder. The company had entered the surcharge regime in its period 04/15, when the DD had failed. HMRC wrote to the company to say that the DD had been cancelled as a result; the VAT for the 07/15 period was paid on time by BACS. HMRC sent several letters stating that no DD had been set up. It appeared that the business had incorporated and confusion had arisen about the nature of the DD when a new one was established for the limited company – the company thought that a regular payment DD had been set up, but in fact it would only allow a one-off payment.

The judge considered that a prudent and responsible taxpayer would have investigated the situation in more detail with the bank after receiving several letters from HMRC about the DD. As it had not done so, the mistaken belief about the DD was not reasonable (even if "honest and genuine"). The appeal was dismissed.

First-Tier Tribunal (TC05301): *Benwick Sports Ltd*

A company appealed against a 10% surcharge of £1,580 levied for its 09/15 period. The appeal was settled on paper. The trader had always paid by Faster Payments; its accountant had assumed that it paid by direct debit, so applied the payment schedule for DDs. This seems unlikely, as a belief that there was a DD would have resulted in no payment being made at all. The judge did not consider it to be a reasonable excuse.

First-Tier Tribunal (TC05302): *ABC Countdown Cars Ltd*

A sole trader appealed against a 15% surcharge of £217,701 in respect of her 08/15 period. She had a poor prior compliance record, but the previous return periods had only small liabilities, so the total surcharge paid up to 05/15 was £298. The liability for 08/15 was much higher because she had sold a parcel of development land that she had inherited and opted. The sale value was over £10m.

The Tribunal considered that her defence of reasonable excuse failed because it amounted to "pressure of work". There was nothing to show that any unforeseeable event beyond her control had caused the failure; her compliance record was regularly poor.

The Tribunal considered the precedents on proportionality in considerable detail, and concluded that this penalty was not so great, in the context of a £10m land sale, as to be manifestly unfair. The exceptional nature of the transaction did not make the penalty exceptional. The appeal was dismissed.

First-Tier Tribunal (TC05306): *Susanna Claire Posnett*

A company appealed against a 2% surcharge of £1,231 levied for its 09/15 period. The payment was due on a Saturday and was received on the Monday following. The director claimed that there was a "genuine misunderstanding" arising from the transaction needing to be carried out on a non-working day, but the Tribunal did not accept that this was a reasonable excuse. Previous surcharges had been cancelled or reduced, and the judge was satisfied that the director ought to have understood the strictness of the rules by this time. The appeal was dismissed.

First-Tier Tribunal (TC05308): *DCC Logistics Ltd*

A company appealed against a 10% surcharge of £620 for 11/15. The essence of the appeal was that the trader had "run out of time" on the due date for the return when trying to catch up after Christmas, and the penalty was unfair. The trader also claimed that he had not defaulted enough times to trigger a 10% surcharge, but no evidence appears to have been presented to support this.

It is interesting that the judge, Dr Khan, refers to the *Equoland* decision of the CJEU as a basis for considering whether particular surcharges are unfair and should be cancelled. However, he did not consider that this penalty fell within the parameters either of reasonable excuse or of "plainly unfair". The appeal was dismissed.

First-Tier Tribunal (TC05359): *Ivy Stationery Ltd*

A football club appealed against surcharges of £1,458 at 5% for 05/15 and £1,131 at 10% for 08/15. Much of its case related to cash flow difficulties, which included reference to the loss of some sponsorship income. The Tribunal did not consider that this met the *Steptoe* test. A TTP arrangement was agreed for 05/15 but only after the due date, and not asked for in respect of 08/15. The appeal was dismissed.

First-Tier Tribunal (TC05362): *AFC Telford United*

A company was denied input tax of £261,389 for its 08/06 period on MTIC grounds. It subsequently failed to pay VAT on time for a number of periods, and claimed that the refusal of the input tax claim gave it a reasonable excuse. The total surcharges at issue were £41,822. The appeal against the input tax refusal had been dismissed; the company said it had appealed further to the Upper Tier.

The Tribunal held that offsetting the current liabilities against a disputed claim was not a reasonable excuse for non-payment. Until and unless the appeal succeeded, the VAT on the later returns was due, and the company was in default. The appeal was dismissed.

First-Tier Tribunal (TC05379): *Eurotrade (W) Ltd*

6.8.2 Penalties

A company appealed against penalties for late filing of EC Sales Lists: £500 for the period 09/14 and £780 for the period 12/14. The trader did not appear at the hearing and was not represented. The company had filed its first ECSL for 06/14 on 16 October 2014 and had been issued with a penalty liability notice. The ECSLs for the following two periods were both filed on 7 April 2015, resulting in the two penalties.

The grounds of appeal were that the ECSLs had been posted, and that the company could not know that they had not arrived until the penalty assessments were received. The judge considered the circumstantial evidence, as there was no direct documentary proof of posting, and concluded that the company could not establish on the balance of probabilities that it had posted the returns. The penalties were confirmed.

First-Tier Tribunal (TC05267): *AGC Customs Ltd*

A trader was assessed to a penalty on the "deliberate, not concealed" scale, with maximum mitigation for a prompted disclosure. The potential lost revenue was £170,000 omitted from a VAT return in relation to the

sale of a property. The trader argued that the error was not deliberate and the disclosure was not prompted.

The property was a pub which the trader had purchased in 2009 and opted in the same year. It was sold to McDonalds in 2014. An invoice was raised showing the VAT of £170,000. There were some legal problems with the police putting restraints on his access to the funds. In the end, the transaction was included on the return for March 2015. In discussions between HMRC, the trader and his accountant, it appeared that the trader had deliberately excluded the transaction from the VAT returns because he had not received the proceeds and therefore could not afford to pay the VAT to HMRC.

The trader's representative argued that he had not appreciated the finer details of the tax point rules. He had told his accountant to include the property sale on the March VAT return before he had received any notice of enquiry from HMRC, so it was an unprompted correction.

The judge considered that, on balance, HMRC had not proved that the trader himself understood the tax point rules. His accountant did, but it was possible that the trader had not given him the invoice at the proper time because of a mistaken belief that the receipt determined the VAT accounting. That was a careless error, because he should have taken advice on such a significant transaction, but it was not necessarily deliberate.

On the other hand, a disclosure has to be made to HMRC – it is not merely a correction. The penalty was therefore reduced to 15%, being the correct amount for a prompted disclosure of a careless error. The judge did not accept that the reduced penalty in FA 2007 Sch.24 para.8 could apply ("delayed tax") – that was for automatically reversing errors (such as understating closing stock), rather than something such as this that was a decision in one period to enter something that had been omitted in an earlier period.

The penalty was reduced to £25,500.

First-Tier Tribunal (TC05377): *Salim Miah*

HMRC have issued an updated version of their Factsheet *Compliance checks – Penalties for VAT and excise wrongdoings*. There is no separate identification of what has changed, but the Factsheet gives details of relatively recent developments such as publishing details of deliberate defaulters and alternative dispute resolution. It also goes through the basic rules for the penalties and their mitigation, including the factors of telling, helping and giving access, and how HMRC assess the nature of the taxpayer's behaviour.

CC/FS12

6.8.3 Time limits for appeals and reinstatement

An individual was assessed under s.61 VATA 1994 and FA 2007 Sch.24 in respect of dishonesty penalties incurred by his company. The total assessed was £138,236; according to HMRC, there had been systematic understatement of sales over the whole life of the company from its incorporation in 2004 to its winding up in 2013. This had first come to light in 2011 when the company (a wholesaler of alcoholic drinks) made a

repayment claim which triggered an enquiry. Assessments were raised totalling £167,320; later, dishonesty penalties were added.

The company appealed and applied for a statutory review out of time. HMRC extended the deadline for this review several times, but eventually upheld the assessment and the penalties on 12 June 2014. The director replied to this decision, disputing it, but was told he could only proceed further by appealing to the Tribunal. He did not do so until over a year later, by which time the company had been wound up and it was no longer possible to appeal against the assessments. Nevertheless, he maintained an appeal against the penalties. HMRC objected to the appeal being brought out of time.

The judge considered the arguments put forward by the taxpayer and the precedent on extending time in *Data Select*. He considered that, in the context of the history of the dispute and in view of the lack of merit in the substantive appeal, he should not exercise his discretion to extend time. The application was struck out.

First-Tier Tribunal (TC05222): *Andrew Holmes*

An individual applied for leave to appeal out of time. An initial date for a hearing was postponed from December 2015 because he was going to be in Australia until the beginning of May; he did not turn up on 6 May and denied knowing about the date when contacted by telephone, even though the HMRC representative had been in contact with him about it by e-mail. The judge decided to proceed with the hearing in his absence.

The application related to post-clearance demand notes for unpaid VAT of £2,388 issued on 28 and 29 April 2008. The appeal was not properly lodged with the Tribunal until 6 July 2015. The delay was so long, and the explanation so inadequate, that there could be no question of allowing the trader's application. Permission to appeal was refused.

First-Tier Tribunal (TC05199): *Andrew Budgen*

A company applied for leave to appeal out of time against five post clearance demand notes totalling approximately £9,500. As usual, the Tribunal considered the seriousness of the delays, the explanations given, and all the circumstances. Although the judge had some sympathy with the problems that a refusal would cause the company, "we think that it is incumbent on a company which is conducting a business and engaging in litigation over the tax affairs of the business to display at least a rudimentary grasp of the relevant processes." The application was refused.

First-Tier Tribunal (TC05294): *77 Diamonds Ltd*

An individual applied for leave to appeal against a 2008 assessment for £6,330. The basis of the appeal was that the assessment had been raised in respect of undeclared bankings which the trader said were loans from his mother; no evidence to support this had been produced in the course of extensive correspondence in 2008/09, and the trader's account of what had happened and what had been provided in the past was inconsistent and unreliable. The application was refused.

First-Tier Tribunal (TC05283): *Stephen Howard Pearce*

A company appealed against refusal of input tax. There were two separate disputes, one relating to £12m denied in connection with fraud, and one relating to £1.28m where HMRC did not consider there was any link to taxable supplies. The company had gone into liquidation, and the Tribunal had issued directions in 2011 requiring the liquidator to confirm whether the appeals would be proceeded with. There were numerous twists and turns in the progress of the appeals after that, but in the end they were struck out by the FTT in April 2012. In January 2015, the FTT refused to extend time for them to be reinstated. The company appealed to the Upper Tribunal. The UT noted that the approach to such cases has changed since January 2015; more recent decisions, such as the CA judgment in *BPP*, would weigh more heavily against the taxpayer than the *Data Select* principles applied by Judge Blewitt in the FTT. It is therefore not surprising that, after detailed consideration of the grounds of appeal put forward, the UT judges concluded that "Judge Blewitt exercised the discretion with which she was entrusted with care having considered all relevant factors and considering none that were irrelevant. Her decision was plainly within the generous ambit of the discretion entrusted to her and there is no proper basis on which we should interfere with it."

Upper Tribunal: *Clear plc (in liquidation) v HMRC*

A company applied in February 2014 to serve a substituted Notice of Appeal and then to amend it again. The substantive issue, which dated from 2008, was related to the *Rank* litigation: the company had in 2006 reclaimed £2.5m in output tax accounted for on the takings from gaming machines. By Tribunal direction in 2008, the case was "sisted" (deferred) pending the publication of the Tribunal's decision in *Rank*. Following Rank's success in the Tribunal, in 2010 HMRC repaid a slightly lower sum (£2.25m) plus interest, but stated that if they were successful in their appeal they would enforce protective assessments to recover it again. This they did in January 2014.

The company's application in February 2014 sought to update the position in the dispute. HMRC said that it included an appeal against decisions made in August 2010 that should have been appealed at the time. In effect, the repayment in 2010 had settled the 2008 appeal; the protective assessments issued with the repayment were a separate matter.

Judge Scott considered the principles of allowing late appeals in detail. She said that HMRC were correct according to the law, and the appeal against the protective assessments was very late; however, the trader's misunderstanding of the position was a reasonable excuse, and it had acted promptly once that excuse had been removed (by HMRC seeking to enforce the protective assessments). Weighing everything together, including the very substantial potential prejudice to the appellant, the judge decided to allow the late appeals against the 2010 assessments to proceed.

First-Tier Tribunal (TC05311): *Carlton Clubs Ltd*

Judge Anne Scott had to consider strike-out applications by HMRC and an application for leave to appeal late by the taxpayer in a case involving penalties amounting to millions of pounds of underdeclared VAT. Because it is not a substantive hearing, the decision report gives very few clues as to what had actually gone wrong. The appellant had put forward inconsistent stories and had failed to cooperate with HMRC over a very

long period, including failing to provide an address after the Tribunal had directed him to do so. After a long rehearsal of the history of the dispute, without giving any detail about its subject-matter, the judge agreed to HMRC's applications and refused the appellant's.

First-Tier Tribunal (TC05320): *David Charles Allen*

An individual applied for an earlier strike-out of his appeal to be lifted, and for an additional ground of appeal to be admitted. The underlying dispute related to the disallowance of £273,000 of input tax claimed by a company, Reddrock Ltd, of which the individual was sole director. The FTT had found against Reddrock, and this was confirmed by the Upper Tribunal early in 2014. A penalty was then issued to the company and assigned to the individual under s.61 VATA 1994. This was the subject of the present appeal.

The judge considered the history of the dispute involving both the company and the individual. He dismissed the application to reinstate the appeal, and further issued conclusions on HMRC's counter-application to have the appeals struck out, as he had heard argument. Had he reinstated them, he would also have struck them out as having no reasonable prospect of success. The FTT had found that the company had acted dishonestly; he was its controlling mind; it was therefore entirely proper for HMRC to apply s.61. To attempt to argue the dishonesty point again would be an abuse of process.

First-Tier Tribunal (TC05326): *Richard Galvin*

6.8.4 Costs

A company is in dispute with HMRC over partial exemption calculations in relation to marketing and other promotional costs. The assessments are for more than £26 million. Appeals have been lodged. At a case management hearing, the Tribunal was asked to consider two matters on which agreement could not be reached concerning the conduct of the appeals:

- whether the company should be allowed to withdraw a request to be excluded from the costs regime;
- whether HMRC should be allowed to introduce in evidence a "without prejudice" letter from Deloitte, the company's representatives.

On the first question, the judge was not convinced that an opt-out can be withdrawn. It is a one-off event that must be made within a limited time (28 days from the categorisation of the case as "complex"); it is intended to provide certainty to both parties. The reasons for the change of mind given by the taxpayer were not enough to overturn this principle. In addition, the delay was more than 2 years; the company had been professionally advised throughout that period, and if it was correcting a mistake, it should have done so much earlier.

A "without prejudice" communication is protected from disclosure in evidence in order to enable parties to negotiate in an effort to reach a settlement, without fear that points made in the course of negotiations may be held against them later. The judge reviewed the principles of identifying "without prejudice" communications and the application of the

rule. HMRC argued that, although the letter from the Deloitte partner was headed "without prejudice", it was not part of a genuine negotiation aiming at a settlement. It was therefore not protected by the principle. The judge considered that, on balance, it was. In the context of the dispute and the state of the appeal at the time, it was an "opening shot" in the negotiation. HMRC could ask for further and better particulars in relation to the matters set out in the letter, which they said they would do, but they could not adduce the letter itself in evidence.

First-Tier Tribunal (TC05198): *N Brown Group plc and another*

6.8.5 Appealable decision

A company registered in Jersey was told by HMRC that it should be registered for VAT on the basis that it was supplying services from a fixed establishment in the UK. A penalty was raised under s.67 VATA 1994. The company argued the unusual ground that there was no appealable decision, so the Tribunal would not have jurisdiction to consider the matter. This was on the basis that the "decisions" were in the form of letters that did not appear to contain a final conclusion. The letter stated that the company had been trading above the threshold and should be registered, and asked for a schedule of income from UK clients; the judge concluded that this was not hypothetical but a clear decision about registration, and s.83 was therefore engaged.

The taxpayer's counsel argued that the registration certificate was invalid because it had been sent to the wrong address. The judge agreed with HMRC's counsel that a registration does not have to be "notified" to be effective. The backdated registration to April 2008 was therefore also an appealable decision.

There is a requirement for a penalty to be notified to the taxpayer. The judge relied on the precedent of *Grunwick Processing Laboratories Ltd v Customs & Excise* (1986) in arriving at the conclusion that failure to notify does not wholly invalidate the penalty – it simply makes it unenforceable until it is notified. Later notification therefore rectified the failure. However, the letter accompanying the penalty notification stated that the company could "ask for" a review, rather than explaining that it had a statutory right to a review. The judge considered that this was a significant failure and it invalidated the decision. As a result, there was no appealable matter in respect of the penalty.

It would appear, therefore, that there will have to be a hearing to discuss the registration decision; the question of liability for VAT and any related penalty seems likely to be subject to more convoluted legal argument. Although the case does not spell out who the taxpayer is, it has a similar name to a firm that sold aggressive tax avoidance schemes, and HMRC may be keen not to let them off the hook.

First-Tier Tribunal (TC05375): *NT Ada Ltd*

6.8.6 Procedure

A firm of advisers provided services to a loan provider in relation to the mis-selling of payment protection insurance (PPI) policies. The firm argued that its services were within the exemption for relevant related

services performed by insurance brokers and agents. HMRC disagreed, and the matter was appealed.

The advisers obtained a report from a Chartered Intermediary and a Fellow of the Chartered Insurance Institute to explain the complex regulatory framework applicable to insurance contracts. The report also used the individual's experience and expertise to give an opinion on how the framework applied to the services in issue in the context of the insurance industry. They applied to have this report admitted as expert evidence in the appeal.

HMRC objected, arguing that the evidence was irrelevant to the issue before the tribunal; that it gave views on the law and on interpretation of contract, which were contested issues and as matters of law are for submission; and that it sought to answer the very questions of VAT law which it was for the tribunal to reach a conclusion on. They asked the FTT to rule the report inadmissible in advance, rather than considering its significance during the substantive hearing, because admitting it would involve HMRC in time and cost.

The FTT considered the law (rule 15 of the Tribunal Rules SI 2009/273), which allows admission or exclusion of evidence on a wider basis than would apply in a civil trial. There were a number of precedent cases on the issue, with the overriding principle appearing to be that evidence should be admitted unless there was a compelling reason not to do so. The Supreme Court had considered the question in a recent case and had identified four factors to take into account:

i) whether the proposed skilled evidence will assist the court in its task;

ii) whether the witness has the necessary knowledge and experience;

iii) whether the witness is impartial in his or her presentation and assessment of the evidence; and

iv) whether there is a reliable body of knowledge and experience to underpin the expert's evidence.

Only the first of these was in issue in the present case. The judge (Swami Raghavan) derived the following principles:

(1) Relevant evidence should be admitted unless there are compelling reasons not to. The prejudice to each party of respectively admitting/not admitting the evidence should be weighed. (*Mobile Export 365* and *Atlantic Electronic*).

(2) An expert's evidence of opinion is admissible because it is the product of a special expertise which the tribunal does not possess, or even if it does, which is not its function to apply (*Hoyle*).

(3) Expert reports are not rendered inadmissible because they refer to legislation, matters of law or indeed the very issue before the court or tribunal. Tribunal panels (who are not lay finders of fact) can be credited with the ability to distinguish between inadmissible/admissible matters in a report and to know that they have to reach their own view on the legal question before them. (*JP Morgan Chase Bank*, and *Kennedy*)

(4) Even if reports contain inadmissible expert evidence of fact they can be admitted and should be admitted without requiring excision

particularly if the admissible/inadmissible evidence of fact is intertwined (*Hoyle*).

The judge drew a distinction between matters where it would be more appropriate for the parties' arguments to be clearly presented as legal submissions for the tribunal's consideration, and those matters that would benefit from expert evidence. A considerable amount of this expert's report fell into the first category. HMRC were justified in arguing that including such material in an expert report would blur the borderline between evidence and argument.

The judge ruled that certain sections of the report would be admissible, but others would not. Rather than deleting particular lines, whole sections would better be presented as part of the appellant's legal submissions. The parties were invited to draw up an agreed statement of issues and a statement of agreed facts for the benefit of the tribunal in the substantive hearing. Overall, this was a success for HMRC.

First-Tier Tribunal (TC05231): *Deloitte LLP*

A partnership appealed against an assessment in November 2012. The appeal notice stated that a hardship application had been made to HMRC and agreed; this had not taken place, and when such an application was later made, HMRC refused it. The question of hardship finally came before the Tribunal in April 2016. The taxpayer was not represented, having sent an e-mail to the Tribunal shortly beforehand stating that the matter had now been settled by agreement.

The appeal, and the prior issue about hardship, had been stayed in 2013 while the parties tried to resolve the dispute through Alternative Dispute Resolution. This led to a reduction in the assessment from £99,719 to £21,048; when ADR was completed in early 2014, the company stated that it wished to appeal against that reduced figure.

There were a number of difficulties in considering the hardship application. HMRC could revert to the higher figure of assessment if the trader rejected the ADR conclusion. The question of timing was a problem where the dispute had taken so long: the judge decided that it was most practical to consider the trader's resources now, rather than in 2013 when the original application was rejected. However, no evidence had been presented to show that the trader would currently experience hardship in depositing the tax in dispute, whether that was the lower figure or the higher one. The application therefore failed.

First-Tier Tribunal (TC05209): *Javed and Azra Mughal (Partnership)*

A company appealed against an assessment for £597,172, denying input tax credit for periods 07/13, 10/13 and 01/14. The assessments were based on *Kittel* and an alleged connection with fraud. HMRC served their statement of case for the substantive appeal on 22 January 2016; the appellant applied for "further information" on 4 February. There were disputes about whether documents had to be listed in advance or could be served with witness statements. The Tribunal had to rule on a number of matters of case management.

Judge Mosedale set out her understanding of what the appellant is entitled to expect from HMRC's statement of case. Both parties were agreed that pleadings must be clear and unequivocal and have sufficient detail or

particularity, and that because this was a case where fraud was alleged the higher standard of particularity required in fraud cases applied. In this case, dishonesty was clearly alleged against the appellant, and vehemently denied. However, the appellant did not consider that HMRC's case set out the nature of the alleged fraud clearly enough.

In the *Citibank* case, Judge Mosedale considered that it was not appropriate to require HMRC to provide "full" or "exhaustive" particulars. However, they were required to plead the primary facts on which they would rely, and that was without prejudice to any possible application to amend their pleadings that might be made once witness statements had been exchanged. The appellant in the current case did not agree with this, arguing that more detail was required. The judge reviewed a number of precedents and confirmed her previous view: primary facts must be pleaded, together with sufficient detail to understand what inferences the court will be asked to draw.

She then went through a list of 31 specific requests for further details submitted by the appellant, rejecting nearly all of them. Most of the matters could wait for witness statements, when it would be possible for the appellant to ask again for further information.

The decision concludes with a number of directions concerning the production of witness statements and the disclosure of documents. A further case management hearing is likely in March or April 2017, so the substantive hearing is still some time away.

First-Tier Tribunal (TC05274): *Ronald Hull Junior Ltd*

6.8.7 Information notices

An individual appealed against an information notice served on him requiring the production of bank statements for a particular account for the period from 1 December 2009 to 31 August 2015. The fundamental issue was whether the bank statements constituted "statutory records", in which case there would be no right of appeal against the information notice – HMRC are always entitled to see statutory records, and do not have to justify them on the basis of "reasonable requirement".

The disputed account had been used, according to the trader, to receive a VAT repayment in relation to VAT registration in 2006, and to make loans to (and receive repayments from) a number of businesses and companies. In his view, that did not make it a "business account".

The judge noted that this account had been notified to HMRC on the VAT 1 form and was the only account notified to them for some 9 years, even though the trader had later opened a separate business bank account. The trader had received regular VAT repayments into the account. This was enough to make it a statutory record; the judge agreed with the appellant that the occasional injection of funds into other businesses would not have been sufficient.

The appeal against the notices was refused.

First-Tier Tribunal (TC05299): *Philip Akrill*

6.8.8 Striking out appeals

Judge Mosedale heard an appeal against a notice issued in February 2010 requiring the taxpayer to file a VAT return online. The appeal was stayed behind the *L H Bishop* case, in which the same judge held that the law contravened human rights legislation, leading to changes in the conditions for and exceptions to online filing. Most other related appeals were settled, but a number were not, all relating to the inability of a particular agent to file online. HMRC applied to have most of these struck out on the grounds of "no reasonable prospect of success", and that happened on 22 October 2015. The last such outstanding appeal was subject to a request by HMRC for further and better particulars, following which HMRC applied to have that struck out as well. It came before Judge Mosedale in July 2016.

She had struck out the other appeals relating to the same agent, and she now struck this one out as well. She explained (again) that the *Bishop* decision was of no assistance. The appellant had to have "victim status" to bring a human rights defence: he could not use his appeal to assert the agent's human rights. Further, this appellant was not computer illiterate or subject to any of the disadvantages that were considered in *Bishop*: rather, he had chosen to use an agent who refused to file online. The agent was not discriminated against, because all agents were treated the same, and the judge considered the law well within the UK's "margin of appreciation" on such matters.

The judge noted that it appeared that HMRC had, by concession, allowed paper filing to continue while the matter was subject to appeal. The result of her striking this appeal out would therefore not lead to the imposition of penalties, but would bring that concession to an end.

First-Tier Tribunal (TC05271): *Michael Clements t/a The Glass Centre*

A trader appealed against an assessment for £957 in relation to incorrect operation of the flat rate scheme. HMRC applied for strike-out on the grounds of "no reasonable prospect of success". The judge noted that the trader did not dispute the accuracy of the assessment, but complained about the conduct of HMRC, including misleading advice given in response to queries. This was not within the Tribunal's jurisdiction, so the judge had no choice but to strike out the appeal.

First-Tier Tribunal (TC05295): *Anne Elizabeth Mitchell*

An appeal from 2007 concerning £1m of disallowed input tax was abandoned and then reinstated early in 2016. The main appellant was in poor health and his co-appellant, his wife, was only nominally involved in the business. No witness statements had been produced. The taxpayers' long-standing representative had recently died. HMRC argued that the case was not being pursued with reasonable diligence. Judge Mure decided that the appellants should be given one last chance, but with the explicit threat of striking out if a realistic timetable for production of witness statements and list of documents was not provided and adhered to.

First-Tier Tribunal (TC05205): *Patrick John Miskelly and another*

6.9 Other administration issues

6.9.1 Consultations on participating in VAT fraud

HMRC are consulting until 11 November 2016 on the possible introduction of a penalty specifically aimed at the situation in which input tax is disallowed because someone knew, or ought to have known, that their transactions were connected with VAT fraud. The aim is to design a penalty whose severity does not rely on HMRC having to distinguish between 'deliberate' or 'careless' offences and which discourages frivolous appeals.

HMRC's problem is that a "deliberate" penalty requires them to decide and then show that the trader "knew", while "careless" would apply to "ought to have known". HMRC's usual practice is to delay issuing a penalty until the substantive fraud issue is finalised, including any litigation. This often results in a second round of litigation against the penalty. The consultation suggests a new kind of penalty that can be issued at the same time as (and therefore argued about at the same time as) the main decision. Two main options are considered:

- a fixed rate 30% penalty for all cases where the knowledge principle is applied – this would remove the scope for two Tribunal hearings, one for the VAT case and one for the penalty, on the same issue; or
- an 'early payment' system with a lower 25% rate for cases where the knowledge principle is applied, but with an increase to 50% when a court finds on appeal that there was actual knowledge – this would target the level of the penalty at the underlying behaviour, although HMRC are mindful of concerns that this option may be seen as discouraging legitimate appeals.

HMRC's preference is for the new penalty also to target company officers. Since companies involved in VAT fraud often have few assets, targeting the individuals behind the fraud is seen as the most effective way to ensure recovery.

For both options, HMRC's proposed approach is that the new penalty regime would not allow any reductions in the level of penalty for disclosure of information or cooperation.

Views are also sought on whether 'naming and shaming' is a suitable sanction to be applied where the participant 'should have known' about the fraud, as well as where there was actual knowledge.

www.gov.uk/government/consultations/penalty-for-participating-in-vat-fraud

6.9.2 Consultations on making tax digital

HMRC are consulting until 7 November 2016 on changes that will be necessary to introduce digital tax accounts for small businesses, the self-employed and landlords with an annual income of £10,000 and over. This is one of a package of six consultation documents on the government's plans for 'making tax digital', applying to income tax, NICs and CGT from 1 April 2018, VAT from April 2019, and corporation tax from 2020.

The consultation document sets out how digital record keeping and regular updates will work in practice, principally in relation to unincorporated businesses. It is split into the following elements:

- acquiring digital tools;
- digital record keeping;
- establishing taxable profit;
- providing HMRC with updates;
- 'end of year' activity;
- exemptions.

www.gov.uk/government/consultations/making-tax-digital-bringing-business-tax-into-the-digital-age

A second consultation covers proposed tax administration changes to support digital tax accounts, including enquiries and safeguards, new late filing and late payment penalty models and alignment of interest across taxes.

There will have to be changes to the procedure for compliance checks if there is no single "tax return" that could be subject to enquiry. There will be a combination of enquiry powers into returns and digital amendments.

A proposed new approach to late submission penalties would not apply penalties to each failure, but would instead use a much more gradual model whereby each failure would attract penalty points, resulting in a penalty charge only once the points reach a set level.

New sanctions for late payment involve two proposals:

- penalty interest to be charged on taxpayers who fail to pay in full within fourteen days of the due date, or who before that date have failed to enter into arrangements to pay over an agreed period to which they then adhere; or
- revision of existing legislation to deliver an aligned penalty regime for income tax, VAT and corporation tax.

On interest, the government plans to take a phased approach to align the interest regimes to ensure a simpler, clearer system in future across the taxes.

www.gov.uk/government/consultations/making-tax-digital-tax-administration

A third consultation discusses the government's plans to provide businesses who keep their records digitally and provide regular updates to HMRC, with a facility to make voluntary payments on a 'pay-as-you-go' basis. This will apply to those unincorporated businesses, sole traders and landlords in respect of their income tax/NICs/CGT from 1 April 2018, to VAT from April 2019, and to incorporated businesses in respect of their corporation tax affairs from 2020.

www.gov.uk/government/consultations/making-tax-digital-voluntary-pay-as-you-go

A further consultation proposes four possible ways of simplifying tax for unincorporated businesses: increasing the annual turnover limit for the

cash basis; reforming basis periods; simplifying reporting requirements; and reforming the capital/revenue divide within the cash basis. All of these relate to direct tax rather than VAT.

www.gov.uk/government/consultations/business-income-tax-simplifying-tax-for-unincorporated-businesses

A fifth consultation on the use of a simplified cash basis for unincorporated property businesses also relates only to direct tax.

www.gov.uk/government/consultations/business-income-tax-simplified-cash-basis-for-unincorporated-property-businesses

6.9.3 Consultation on penalising avoidance promoters

HMRC are consulting until 12 October 2016 on:

(1) new tax-geared penalties aimed at all planners, advisers and middlemen who benefit financially from enabling tax avoidance schemes which have been defeated in a court or tribunal;

(2) modifying the existing penalty regime to shift the burden of proving ‘reasonable care’ on to those taxpayers who use such schemes; and

(3) introducing other deterrents. The trigger for ‘enabler penalties’ would be the defeat of a scheme, irrespective of the penalty position of users.

www.gov.uk/government/consultations/strengthening-tax-avoidance-sanctions-and-deterrents-discussion-document

6.9.4 More consultations: hidden economy

HMRC have announced three consultations, running until 21 October 2016, on possible measures to tackle the “hidden economy”.

The first proposes the principle of introducing a condition that businesses must be able to prove tax registration before they can gain access to certain business services. This could include access to licences such as those issued by local authorities for private hire vehicles, trading, scrap metal, environmental health, planning, or property lettings. It could also include licences issued by other government departmentsor by trade and representative bodies for specific sectors.

www.gov.uk/government/consultations/tackling-the-hidden-economy-conditionality

The second relates to extending HMRC’s bulk data-gathering powers to include money service businesses as a new category of ‘relevant data-holder’. The aim is to allow HMRC to collect data on who their customers are, and the volume and value of transactions carried out by these customers. Existing data gathering powers were introduced in 2013, covering “merchant acquirers” (who process debit and credit card transactions).

www.gov.uk/government/consultations/tackling-the-hidden-economy-extension-of-data-gathering-powers-to-money-service-businesses

The third consultation considers new penalties and sanctions for those operating in the hidden economy. It includes some interesting statistics about the number and level of penalties charged in 2015/16 under the existing rules:

Behaviour	Penalty range	Number	% reduced for disclosure	Average % charged	Average penalty amount
Non-deliberate	0% to 30%	1,500	99%	19%	£2,000
Deliberate	20% to 70%	5,500	86%	46%	£3,600
Deliberate and concealed	30% to 100%	100	80%	81%	£26,700
Total		7,100			

The proposals are for increasing the sanctions, in particular for repeated failures (such as someone who has been caught in the hidden economy, then falls out of self-assessment and continues the same behaviour).

www.gov.uk/government/consultations/tackling-the-hidden-economy-sanctions

6.9.5 Campaigns

HMRC have issued further guidance on three "disclosure campaigns", encouraging those with undeclared tax liabilities to put their affairs in order with the promise of reduced penalties. They are aimed at direct taxes, and VAT liabilities are not included; however, a disclosure could lead to VAT liabilities as well. They relate to:

- Income from let property (opened September 2013, no end date set)

www.gov.uk/government/publications/let-property-campaign-your-guide-to-making-a-disclosure

- Second incomes (opened April 2014)

www.gov.uk/government/publications/second-incomes-campaign-your-guide-to-making-a-disclosure

- Credit card sales (opened October 2014)

www.gov.uk/government/publications/credit-card-sales-campaign-your-guide-to-making-a-disclosure

The website guidance explains how to make a disclosure in order to qualify for more lenient treatment, and how the penalties are calculated. The credit card sales guidance makes specific reference to VAT corrections and late registrations.

HMRC opened a "digital disclosure service" on 5 September 2016. This provides a single online access point for individuals and businesses to make voluntary disclosures relating to income tax, CGT, NICs and corporation tax, including the worldwide disclosure facility for offshore sources. Agent disclosure forms were added on 21 September. The "worldwide disclosure facility" version relates to disclosures that involve, in whole or in part, an offshore matter.

Note that such disclosures can have a consequence for VAT, but VAT is not included.

www.gov.uk/government/publications/hm-revenue-and-customs-disclosure-service; www.gov.uk/guidance/worldwide-disclosure-facility-make-a-disclosure

6.9.6 Finance Act 2016

The Finance Bill completed its passage through the House of Commons on 6 September. The Bill finally received Royal Assent on 15 September.

services.parliament.uk/bills/2016-17/finance.html

6.9.7 Finance Bill 2017

The Chancellor of the Exchequer has announced that the date of the Autumn Statement will be 23 November 2016. Draft clauses for Finance Bill 2017 will be published on Monday 5 December 2016. Consultation on the draft legislation will run until 30 January 2017.

www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2016-09-15/HCWS165

6.9.8 Annual reports

HMRC have published their Annual Report and Accounts for 2015-16. This shows total tax revenues of £536.8bn, an increase of £19.1bn (3.7%) from the previous year. VAT makes up £116bn (21.6%) of the total, an increase of 1.8% in absolute terms. VAT is the second highest single revenue earner for the government, with income tax on 32% and National Insurance on 21%.

HMRC also announced:

- £26.6bn in compliance revenues secured – making a total of more than £110 billion since 2011/12;
- £14.9bn tax protected through successful litigation;
- £210m annual sustainable cost savings, exceeding the target set by the government.

Less cheerful announcements covered performance on answering post and phone calls:

- HMRC's two main targets for measuring performance in clearing post were: (1) to clear 80% within 15 working days from receipt; and (2) to clear 95% within 40 working days. Actual performance ranged from 31% in May 2015 to 70% in the last four months, giving an overall figure for 2015/16 of 52%.
- HMRC's target for phone calls was to answer a consistent 80% of calls across all helplines. Actual performance for 2015/16 was 72% of calls answered.

www.gov.uk/government/publications/hmrc-annual-report-and-accounts-2015-to-2016

The Public Accounts Committee (PAC) has published its report on 'Quality of service to personal taxpayers and replacing the Aspire contract', which assesses HMRC's customer service performance and management of technology contracts. This is related to HMRC's moves to "making tax digital" considered in their consultations set out in section 6.1.

The PAC makes six main recommendations:

- HMRC must provide an acceptable and consistent level of service to customers that ensures all calls are answered promptly and dealt with effectively. HMRC should set out what level of service it is seeking to provide in the short term and its plans for improving this in the longer term, with a timetable for doing so.
- HMRC must test whether its forecasts of demand are realistic and be prepared to flex its resources as necessary to ensure service demand is met. HMRC should pilot how taxpayers will respond to new digital services before they are widely implemented.
- HMRC should estimate the cost to those using its services, including factors such as charges incurred using the 0300 helpline and time spent waiting on the telephone. It should use this information when considering resource needs to ensure the optimal balance is struck between its own costs and those borne by customers.
- HMRC must make significant progress in understanding and measuring the relationship between service quality and tax revenue, and report back to the Committee on how far it has got by the end of 2016.
- HMRC must ensure continuity in the leadership of the Aspire programme to maximise its ability to design and introduce a new IT model successfully.
- HMRC should update the Committee on progress at each key point in the Aspire programme.

www.parliament.uk/business/committees/committees-a-z/commons-select/public-accounts-committee/news-parliament-2015/service-quality-personal-taxpayers-report-published-16-17/

The Tax Assurance Commissioner's Annual Report 2015-16 reviews HMRC's performance in particular in areas of governance and the handling of disputes. There are a number of interesting case studies about different tax issues and HMRC's response, including this one on VAT:

VAT intervention: suspended penalty and change in behaviour

One of the ways in which HMRC focuses its compliance activity is to use a project-based approach to identify taxpayers who may present a risk to the tax system. HMRC's 'rapidly expanding business project' aims to identify those businesses which have grown quickly and – as a result – may no longer have adequate internal systems. This project identifies businesses at an early stage that present sufficient risk to the Exchequer to warrant a visit to help them improve the robustness of their internal systems and procedures.

One of the taxpayers identified by this project was in the manufacturing sector, had secured a major contract with a large customer and had grown rapidly, presenting a VAT-specific risk. HMRC opened an intervention and the case worker carried out a number of standard checks including build-up of the VAT account, export evidence, lease cars and business entertainment.

These simple tests enabled the caseworker to identify small errors created by an incorrect spreadsheet formula. The spreadsheet had been used by the business from its inception and because the business had grown

rapidly it was no longer fit for purpose. The caseworker educated the business how to complete the calculation correctly and recommended using a more robust accounting package.

The caseworker also identified that the business had outsourced part of its invoice accounting systems to a subsidiary based in another EU state. Due to a lack of knowledge this subsidiary had incorrectly processed the invoices and not correctly applied the HMRC requirement for 50% of the cost of leasing cars to be disallowed for the last four years.

Having explained the errors to the taxpayer, how they had come about and what the business could do to rectify the situation in the future, the caseworker issued an assessment to recoup the over-claimed input tax. The case worker's manager also authorised the case worker to issue a penalty to the taxpayer on the basis that the inaccuracies were the result of the taxpayer's careless behaviour. The penalty was suspended on the conditions that the taxpayer rectified its internal systems to prevent the errors from happening again and it filed all its returns on time during the suspension period.

From the date HMRC made initial contact with the taxpayer, this case took approximately three months to resolve. It represents one of approximately 10,500 VAT interventions that HMRC carries out each year. Where caseworkers and their managers identify best practice or learn lessons with wider application, they share with strategic leads who disseminate those lessons to other teams carrying out similar work.

www.gov.uk/government/uploads/system/uploads/attachment_data/file/536912/How-we-resolve-tax-disputes_HMRC_2015-16.pdf

HMRC have published their Annual Charter Report for 2015-16. It includes comments from individuals, small businesses and agents in relation to the various "charter commitments". Responses were positive in relation to the following parts of the charter:

- Respect you and treat you as honest
- Protect your information and respect your privacy
- Accept that someone else can represent you

Respondents were less satisfied with the following:

- Be professional and act with integrity
- Tackle those who bend or break the rules.

The category "Deal with complaints quickly and fairly" received both good and bad ratings.

www.gov.uk/government/publications/your-charter-annual-report-2015-to-2016

The Adjudicator's Annual Report 2015-16 discloses that complaints about HMRC rose in the year from 1,044 to 1,226, and that total redress paid by HMRC in the year was £946,461.

www.adjudicatorsoffice.gov.uk/pdf/report2016.pdf

6.9.9 HMRC's standards for agents

HMRC have set out the standards of integrity, professional competence and behaviour they expect of agents in a new document.

1. Overview

At HM Revenue and Customs (HMRC), we recognise the significant value that agents add by helping taxpayers meet their tax obligations.

Most agents are members of professional bodies that set standards for professional behaviour.

HMRC expects high standards that promote tax compliance from anyone who offers to represent or give advice to other taxpayers.

2. The standards

2.1 Integrity

We expect agents to be straightforward and honest with HMRC, for example:

- *disclose all relevant information*
- *don't imply that you're regulated for tax by HMRC*

2.2 Professional competence and due care

We expect agents to:

- *keep correct and up to date knowledge of the areas of tax that you deal with*
- *work to prevent errors in your clients' tax calculations or claims*
- *advise your client to take steps to set matters right where you find errors in their tax affairs*
- *keep online access credentials safe from unauthorised use at all times*

2.3 Professional behaviour

We expect agents to:

- *comply fully with tax law and regulations*
- *ensure your own tax affairs are correct and up to date*
- *deal courteously and professionally with HMRC staff*
- *consider the risk to reputation of tax agents, of any arrangements that you advise a client about – for example, tax planning schemes.*

www.gov.uk/government/publications/hmrc-the-standard-for-agents

6.9.10 Compliance checks

HMRC have issued a new version of their Factsheet on penalties for inaccuracies in returns and documents, making a minor amendment to the section on what taxpayers can do to achieve the maximum reduction in any penalties charged.

Only the new version now appears on the HMRC website, so it is hard to identify the minor change. What it says is as follows:

We can reduce the amount of any penalty we charge you depending on our view of how much assistance you gave us. We refer to this assistance as the 'quality of disclosure' or as 'telling, helping and giving'.

Examples of telling, helping and giving include:

- *telling us about, or agreeing that there is something wrong and how and why it happened*
- *telling us everything you can about the extent of what is wrong as soon as you know about it*
- *telling and helping us by answering our questions in full*
- *helping us to understand your accounts or records*
- *helping us by replying to our letters quickly*
- *helping us by agreeing to attend any meetings, or visits at a mutually convenient time*
- *helping us by checking your own records to identify the extent of the inaccuracy*
- *helping us by using your private records to identify sales or income not included in your tax return*
- *giving us access to documents we have asked for without unnecessary delay*
- *giving us access to documents we may not know about, as well as those that we ask to see*

We will reduce the penalty by the maximum amount possible if you:

- *tell us everything about any inaccuracy as soon as you can*
- *do everything you can to help us correct it*

If you delay telling us, you may still be entitled to a reduction but it will be smaller. If we do not need any extra assistance from you we will give you the full reduction that the law allows for telling, helping and giving.

CC/FS7a

6.9.11 Clearances

HMRC have updated their guidance on the non-statutory clearance service. The main change is the addition of a new Annex E, containing a checklist for post-transaction clearance in connection with an offshore disclosure being made via HMRC's digital disclosure service. Annex D continues to be the relevant section for applying for VAT clearances.

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

6.9.12 Articles

In an article in *Taxation*, Alex Tostevin considers what changes to UK VAT may follow from Brexit. The removal of the requirement to adhere exactly to EU legislation and judgments could allow more use of VAT for social planning and targeted business stimuli; wider exemptions could in particular benefit financial services and insurance; but the loss of the

electronic refund procedure for VAT incurred in other EU member states will add to compliance burdens.

Taxation, 7 July 2016

In another article, Richard Curtis canvasses views of experts on the consequences of Brexit. Neil Warren expresses the view that “life will go on”, but suggests that HMRC might be glad of the removal of lengthy and expensive litigation that eventually results in the CJEU awarding UK taxpayers large refunds.

Taxation, 30 June 2016

6.9.13 Updated Notice

HMRC have updated their Notice *Insolvency*. There are a number of changes listed, mostly involving changes in contact details and procedures, but also the following more technical changes:

- at paragraph 5.8, inclusion of sentence specifying HMRC’s right to verify repayment claims;
- re-write of paragraph 6 to reflect new VAT deregistration procedure for insolvent businesses;
- at paragraph 13, inclusion of a general de-minimis level of £250 for Crown set-off enquiries.

Notice 700/56