VAT UPDATE
OCTOBER 2017

Covering material from July – September 2017

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VAT Update October 2017

Contents

1. INTRODUCTION

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

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

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

1.1 Appeals pending

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

The HMRC website section which reports the progress of appeals originally said that it would be updated monthly, but it appears to be less frequent or regular than that. The list says "updated 8 August 2017" at the top, but lower down says "this list was last updated 5 April 2017". I have made amendments to the list where known developments have happened since.

Several of the "decision is final" 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

- *Associated Newspapers*: HMRC are seeking leave to appeal to the Supreme Court against the Court of Appeal's ruling in relation to the deductibility of input tax on promotional vouchers and the non-applicability of SI 1993/1507.
- *British Film Institute*: CA will consider the CJEU judgment from the April 2017 update (Case C-592/15), which favoured HMRC.
- *Brockenhurst College*: CA will consider the CJEU judgment from the July 2017 update (Case C-699/15), which favoured the taxpayer.
- *CCA Distribution Ltd*: the UT remitted matters in dispute back to the FTT; an oral permission hearing for an appeal to the CA was listed for 11/12 July 2017.
- *DPAS Ltd*: HMRC appealing points from FTT decision to Upper Tribunal, which decided to refer questions to CJEU after considering the judgments in *Bookit* and *NEC*.

- *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 appealing 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. Hearing listed for 18 July 2017.
- *Frank A Smart & Son Ltd*: HMRC are appealing to the Court of Session against UT's confirmation of FTT ruling that costs of Single Farm Payment Entitlements were business overheads and deductible (hearing listed for June 2017).
- *Gala 1 Ltd v HMRC*: Court of Appeal due to hear taxpayer's appeal against refusal of claims for repayment of output tax on bingo – FTT/UT both ruled that only the representative member of the group could make the repayment claim (not on the HMRC list).
- *Hotels4U.com Ltd*: HMRC have applied for the time limit to appeal to be extended while waiting for FTT to rule on whether to refer questions to the CJEU.
- *Iveco Ltd*: company has appealed UT's decision in favour of HMRC in case about repayment claim based on alleged "adjustment of consideration" (hearing date November 2017).
- *LIFE Services Ltd*: HMRC are appealing FTT's decision in favour of taxpayer in case about fiscal neutrality and conditions for exemption of welfare services by commercial company (hearing October 2017).
- *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 concluded 4 July 2017, judgment reserved.
- *Marriott Rewards LLC and Whitbread Group plc*: both appellants' appeals dismissed by the FTT (TC05634) on place of supply issues. However, the FTT found against HMRC on the fundamental direction of supply point. Marriott and Whitbread have both appealed to the Upper Tribunal and HMRC has cross-appealed.
- *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 (A-G's opinion delivered 31 May 2017).
- *Metropolitan International Schools*: HMRC appealed to the UT against the FTT's decision that the taxpayer supplied predominantly printed matter with incidental services (hearing February 2017).
- *MG Rover Group Ltd*: taxpayer has applied to CA for permission to appeal against UT's ruling that its *Fleming* claim could not succeed as it should have been made by the representative member of the group.
- *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 date listed as 30 January 2018).

- *Pacific Computers Ltd*: MTIC case remitted by the UT to differently constituted FTT for rehearing.
- *Praesto Consulting UK Ltd*: the FTT found in favour of company that had claimed input tax deduction on legal expenses relating to lawsuits against a director; HMRC have appealed to the UT (hearing June 2017).
- *Privin Corporation Ltd*: the FTT found in favour of a MTIC appellant. HMRC were granted leave to appeal to the UT, but it was agreed that the case would be remitted to a differently constituted FTT for rehearing.
- *Stoke by Nayland Golf and Leisure Ltd*: HMRC are seeking leave to appeal to the UT against the FTT's ruling that a members' club did not fall foul of anti-avoidance provisions and qualified for exemption.
- *Synectiv Ltd*: the FTT found in favour of a MTIC appellant. UT set aside the decision on "should have known" and the case will be remitted to a differently constituted FTT for rehearing.
- *Taylor Clark Leisure plc*: HMRC have been granted leave to appeal against the Court of Session's ruling that the company was entitled to a repayment based on a claim made by a former member of its VAT group registration.
- *The Chancellor, Masters & Scholars of 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 (CA hearing listed December 2017).
- *Totel Ltd v HMRC*: Supreme Court granted taxpayer leave to appeal against Court of Appeal's 2016 ruling on requirement to pay VAT before an appeal could be entertained (not on HMRC's list).
- *Volkswagen Financial Services (UK) Ltd*: Supreme Court has referred the main partial exemption issue to the CJEU but found against HMRC on a secondary issue.
- *Wakefield College v HMRC*: the college has appealed 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 (hearing listed for 7 February 2018).
- *Wetheralds Construction Ltd*: HMRC are seeking leave to appeal against the FTT's decision that certain works qualified for the lower rate as relating to insulation for roofs, not "insulated roofs".

1.1.1 Decisions in this update

- *BPP Holdings*: Supreme Court upheld the CA's ruling that the FTT was correct to bar HMRC from further participation in the proceedings, dismissing HMRC's appeal.
- *KE Entertainments Ltd*: UT upheld the FTT's decision in favour of taxpayer in case about adjustment of consideration in bingo.
- *SAE Education Ltd*: the CA dismissed the company's appeal against the UT's ruling that the FTT was wrong to allow exemption to the taxpayer as a "college of a university".
- *Temple Finance Ltd and Temple Retail Ltd*: UT upheld the FTT's ruling that, in the main, Sch.6 para.1 directions were not possible and the standard method override did not apply, dismissing HMRC's appeal.

2. OUTPUTS

2.1 Scope of VAT: linking supplies to consideration

Nothing to report.

2.2 Disbursements

2.2.1 Conveyancing fees

A firm of solicitors appealed against an assessment for £67,776 with interest. Given the importance of honesty to a professional firm, the judge started by emphasising: "*this is not a case of dishonesty or misconduct. Nor is it a case of tax avoidance or evasion. It is simply a case as to whether the Appellant's VAT treatment of certain fees was, as a matter of law, correct or incorrect. HMRC has not advanced any criticism as to the Appellant firm's probity or integrity, or the probity, integrity or professional conduct of any of its partners or employees, past or present and it is clear that the Appellant has acted throughout in good faith.*"

HMRC had argued that the appeal should be dismissed on the grounds that the trader did not have sufficient evidence to justify the treatment of certain recharges as disbursements. The judge (Christopher McNall) was "not attracted" by this argument, and declined to dismiss the appeal on that basis. He concentrated instead on what he regarded as HMRC's primary argument, that the appellant was the true recipient of the supplies rather than the appellant's clients. As HMRC had only advanced this argument at a late stage, and neither party had chosen to cross-examine the other's witnesses, the judge considered that the evidential position was not entirely satisfactory. However, he considered that there was sufficient material before him to dispose of the appeal.

He also commented that he could not take into account the fact that HMRC's view was that the firm needed to trawl back through potentially tens of thousands of transactions to decide on the correct treatment for each of them, nor any wider impact on the legal profession in general.

The subject matter of the dispute was property searches carried out as part of the procedure of conveyancing. Searches can be carried out by post or in person, but were most commonly carried out electronically. A specialist agency carried out this work and charged the firm without adding VAT, because local authority searches were not, until 2017, charged to VAT; the firm charged this on to the client without adding VAT, treating it as a disbursement.

HMRC cited the conditions for disbursement treatment in Notice 700, but also referred to art.79 and art.73 PVD: "*the fees are not simply repayment of expenditure incurred in the name and on behalf of the customer (Article 79) but rather constitute consideration obtained, in return for the supply, from their client, and which forms part of the charges for their services (that is, the Appellant's services) (Article 73). HMRC contends that the information within the search results is used by the Appellant to give* *advice to their clients, and hence recovery of the outlay represents part of the overall value of the solicitor's supply to their client.*"

HMRC's internal manuals (VTAXPER 47000) refers specifically to search fees. They may be treated as disbursements only where the fiche (i.e. the underlying information) is passed on without comment to the client. Where it is used by the person paying the fee in order to give advice, as would be normal with a solicitor carrying out conveyancing, HMRC regard it as received by the firm, not the client.

The firm's "general terms of business" contained the following clause:

Payments on your behalf.

We may make specific payments on your behalf. These will be charged separately and may be payable in advance. Unless you instruct us to the contrary, you authorise us to incur as your agent such expenses and disbursements. These might include items such as:-

Search fees and Land Registry fees

Investigation fees

Barristers' fees

Court fees

Fees of other professional consultants

Travel and accommodation while working away from the office

Stamp Duty Land Tax

Stamp Duty – please note that we are not allowed to incur stamp duty on your behalf and recover it from you at a later date and therefore we will always ask for stamp duty in advance of it being due

Fax charges, photocopying charges and courier fees where appropriate

Electronic identification, CHAPS or other electronic bank transfer fees

We will not instruct other professionals or experts on your behalf without informing you first and wherever possible we will attempt to agree their fees on your behalf in advance, these charges within 14 days of them being invoiced.

The judge set out the distinction between expenses and disbursements as follows:

In general terms, VAT law draws a clear distinction in principle between the following two scenarios:

(1) when the relevant expenses paid to a third party C have been incurred by A in the course of making its own supply of services to B and as part of the whole of the services rendered by it to B; and

(2) where specific services have been supplied by C to B (and not to A) and A has merely acted as B's known and authorised representative in paying C.

He considered various arguments put forward by the solicitors and also by the Law Society, but could not agree that the firm was acting as a "middle man". The search was not obtained for the client to make use of – it was for the purposes of the solicitor's services. There was no distinction between "obtaining the search" and "giving the advice". Various precedents supported the view that the search fee was the firm's expense.

The Law Society pointed out that HMRC had accepted, as a concession, that postal search fees could be regarded as disbursements. This dated from 1 October 1991. It would be inconsistent or anomalous to treat electronic searches differently. The judge said that this would be outside his jurisdiction, and in any case the question before him was not whether the treatment of postal fees was right or wrong. He considered the case of *Barratt Goff & Tomlinson* (TC00949), in which Judge Demack had decided that fees paid by solicitors for medical reports in relation to negligence cases could be treated as disbursements; he did not agree with the conclusion, as well as regarding the situation materially different.

The appeal was dismissed.

First-Tier Tribunal (TC06093): *Brabners LLP*

2.2.2 Article

In an article in *Taxation*, Mike Thexton reviews the problems and rules relating to the VAT treatment of disbursements, focusing on MOT tests (including the recent case of *Ellon Car Clinic*) and counsel's opinions.

Taxation, 7 September 2017

2.3 Exemptions

2.3.1 Special investment funds

A UK VAT group included two investment fund management companies. They received services from a US affiliated company, in the form of an "investment management computer platform" that was used to manage investment funds. HMRC ruled that a reverse charge was due on the purchase of the services; the companies argued that the supply was exempt because it was involved in the management of special investment funds.

It was accepted that the US company made a single supply of the platform (called "Aladdin"), and separate supplies of some other services. There were two questions: did the SIF exemption apply at all, when the supply was from one company to another rather than to the individual small investors? And if it did apply, could the reverse charge be apportioned because Aladdin was also used for non-SIF investments? The dispute had been running since a ruling request in 2012, and the hearing covered appeals for the periods from 1 January 2010 to 30 September 2016.

The Tribunal examined the way in which SIFs operate, the way in which the software was used to assist in their management, and the different ways of managing investments before and after the software was introduced.

The judge went on to consider the two main relevant authorities of the CJEU on management of SIFs and outsourcing: *Abbey National plc v C&E* (Case C-169/04) and *GfBk Gesellschaft fur Borsenkommunikation* *mbH v Finanzamt Bayreuth* (Case C-275/11). He set out the following principles:

(1) The exemption in Article 135.1(g) PVD is defined according to the nature of the services provided and not according to the person supplying or receiving the service. (*Abbey National* [66]-[69] *GfBk* [20])

(2) The exemption was an exception to the general principle that VAT is to be levied on all services supplied for consideration by a taxable person, and should therefore be interpreted strictly. (*Abbey National* [60])

(3) The exemption applied not only to investment management involving the selection and disposal of assets under management but also to administration and accounting services. (*Abbey National* [26], [63] and [64] and *GfBk* [27])

(4) Services falling within the exemption included those functions which related to administering the fund, such as those set out under the heading "administration", in Annex II to the UCITS Directive. Annex II was not exhaustive. (*GfBk* [25])

(5) To ensure fiscal neutrality, the transactions covered by that exemption are those which are specific to the business of undertakings for collective investment. (*Abbey National* [62]-[63])

(6) There was nothing in principle which prevented the management of special investment funds from being broken down into a number of separate services. (*Abbey National* [67] *GfBk* [28])

(7) The services supplied fall within the exemption if, viewed broadly, they form a distinct whole, and are specific to, and essential for, the management of special investment funds. (*Abbey National* [72] *GfBk* [21])

(8) Mere material or technical supplies, such as the making available of a system of information technology, are not covered by the exemption. (*Abbey National* [71])

(9) Services which were intrinsically connected to the activity characteristic of an investment management company would have the effect of performing the specific and essential functions of management of a SIF. (*GfBk* [23]) The service of giving recommendations to an investment management company to purchase and sell assets was so intrinsically connected. (*GfBk* [24])

(10) The purpose of the exemption was to facilitate investment in securities by small investors by means of collective investment by excluding the cost of VAT in order to ensure fiscal neutrality when compared with direct investment. (*Abbey National* [62] and *GfBk* [30])

(11) It followed from the principle of fiscal neutrality that investment advice services provided by a third party should not be subject to a disadvantage when compared with funds which provided their own investment advice. Economic operators must be able to choose the form of organisation which, from the strictly commercial point of view, best suits them. (*Abbey National* [68] *GfBk* [31])

The key test, therefore, was whether the services supplied by the US affiliate to the UK companies formed a distinct whole, and were specific to, and essential for, the management of special investment funds. The judge was satisfied that they were "specific and essential": the meaning that HMRC tried to import into that expression was too restrictive. As regards "a distinct whole", the judge noted that the CJEU had not clarified the meaning of this expression, and the A-G opinions in the two cases seemed to be inconsistent. Nevertheless, he was satisfied that the services were "interrelated and had an inner coherence", which he considered to be the test. HMRC had argued that they were "a mere tool used in management of SIFs", but the judge did not agree that this was the relevant test.

Given that the services constituted a single supply, the question was then whether different parts of it could have different liabilities. The company argued that the *Talacre Beach Caravan Sales* case applied, and that apportionment would serve the purpose of the exemption. HMRC responded that the same could be said of any compound supply where part was exempt, and apportionment should only apply in exceptional and clearly defined circumstances.

The judge agreed with HMRC: there were special circumstances in both *Talacre* and *French Undertakers* that did not apply here. The normal rule was that a single supply must have a single liability. The proper functioning of the VAT system required a single liability, and that overrode the purpose of the specific exemption.

The company's appeal would have succeeded on the liability issue, but it failed on the apportionment issue.

First-Tier Tribunal (TC06069): *Blackrock Investment Management (UK) Ltd*

2.3.2 Incidental to education

Loughborough Students Union claimed a repayment of output tax accounted for between 10/11 and 04/15 on sales of stationery, art materials and other items by the union's campus shops. It argued that it was entitled to exemption under art.132 PVD for supplies closely related to education. This was developed by reference to HMRC's policy of extending exemption to certain supplies by universities and students unions, and by reference to the cases of *Horizon College* and *Brockenhurst*.

HMRC responded that the claim was not sufficiently specific. There was no evidence that the supplies had been made to students, nor that the supplies were essential to education. The students union was not involved in the principal supply of education, but rather made supplies to the students and to the public. It did not have an educational aim "either as a matter of vires or as a matter of economic and operational reality". The shops also obtained additional income for the union, which breached the conditions in art.134.

The judge (Peter Kempster) considered the "mechanism" of the PVD in determining exemption:

(1) First, art 132 defines supplies which member states must exempt, and if they fail to do so properly then a citizen can rely on the direct effect of art 132 (MDDP at [51]). Article 132(1)(i) is mandatory in application to "bodies governed by public law having [education] as their aim" but confers a discretion on member states to recognise "other organisations … having similar objects".

(2) Second, where (pursuant to art 132(1)(i)) a member state exercises its discretion and recognises certain non-public law bodies, then art 133 permits (but does not require) the member state to apply one or more of four stated conditions. Applying (or not applying) one or more of the art 133 conditions does not thereby bring an organisation within art 132 which would not otherwise meet the requirements of art 132. An organisation must first satisfy art 132; then if its home jurisdiction has enacted one or more of the art 133 conditions, the organisation must also satisfy those conditions.

The judge considered that Note 1(e) of Group 6 failed the criteria set out by the CJEU in *MDDP*. The provision concentrated on not-for-profit bodies, when exemption should rather depend on the body being recognised as having similar educational aims to public bodies devoted to education. The judge therefore examined the aims of the union, and concluded that it was (quite properly) devoted to supporting the interests of its members and to creating a good social, cultural and sporting life, and providing appropriate pastoral care. Those were commendable objects, but they were not the educational aims that conferred exemption.

It was then not strictly necessary to consider whether the supplies were essential to education and closely related thereto, but the judge considered the question in order to find facts for any possible appeal. In his view, the second restriction in art.134 applied: the basic purpose of the supplies was to generate additional income in competition with commercial enterprises. For that reason, too, the appeal would have to fail, although this section was “obiter dicta”.

Lastly, the judge commented on the calculation of the claim, which he thought was inconsistent in not restricting input tax to the same extent as the output tax reduction. He noted this uncertainty as something to be resolved at a later stage if the appellant was successful in an appeal about the basic principle of the exemption.

First-Tier Tribunal (TC05966): *Loughborough Students Union*

2.3.3 Education

In TC03358, the FTT allowed an appeal by a commercial company which claimed the status of ‘eligible body’ by reason of its close links with Middlesex University. The FTT examined the principles established by the precedent cases of *HIBT* and *School of Finance & Management* (*SFM*), which succeeded in winning ‘eligible’ status in the courts, and the more recent decisions in *London College of Computing* and *Finance & Business Training*, both of which have been decided by the FTT and confirmed by the UT as not qualifying. The following principles were drawn from the precedents:

(1) The SFM factors may be helpful in determining whether a body is a college of a university, but that list of factors is not exhaustive and factors within that list may not always be relevant;

(2) It is necessary to consider the particular circumstances and specific facts of each individual case, which may involve considering factors other than those listed in SFM;

(3) In considering any particular factor, it must be determined whether that factor is compliant with EU law. If it is not, that factor must be put aside and not taken into account in reviewing the evidence;

(4) The "fundamental purpose" test does not replace the similar objects test, but has something in common with SFM factor (ix) (having a similar purpose to that of the university);

(5) There must be at least some degree of integration of the body with the university concerned;

(6) It is inappropriate to follow a "check list" or "tick box" approach. The cumulative effect of the relevant factors must be assessed to derive an overall impression, weighing the factors in the balance: some factors may carry more weight than others.

The 'SFM factors' are matters identified in that case which should be considered in determining whether the links between the bodies are close enough to regard the company as a college of the university. The Tribunal considered the evidence under headings (a) – (o) in detail, and concluded that the following carried the greatest weight:

(1) Status of Associated College, combined from September 2010 with status of Accredited Institution.

(2) Long-term links between SAE Institute and MU. Similar purposes to those of a university, namely the provision of higher education of a university standard.

(3) Courses leading to a degree from MU, such courses being supervised by MU, which regulated their quality standards.

(4) Conferment of degrees by MU, received by SAE students at MU degree ceremonies.

The appeal hearing took longer than the initial time estimates of the parties (three days). In spite of the FTT extending the hearing time each day and making available a fourth day, it was not possible to complete it; there was therefore an adjournment until further court time could be found, which meant that four months passed. After the second part of the hearing, the Upper Tribunal gave its decision in *Finance & Business Training*, which led to further submissions being made to the FTT in this case. The FTT decided that that decision (which was binding on the FTT) did not mean that 100% of a company's activities had to be covered by the 'college of a university' umbrella; it had decided that 90% of this company's activities were so covered, and that was enough. The company's appeal was allowed, entitling it to a repayment of some £1.3m.

HMRC appealed to the Upper Tribunal, which examined the FTT's findings of fact and its reasoning based on those findings. HMRC's challenge to the FTT's decision was based on the assertion that there was insufficient integration between the college and Middlesex University to justify the FTT's finding. HMRC's counsel acknowledged that this amounted to an attack on the FTT's findings of fact, or on the conclusions it drew from those facts; but he argued that those findings were not supported by the evidence, or were based on an incorrect interpretation and application of some of the *SFM* factors. He cited the *Pendragon* decision in the Supreme Court as authority for the proposition that the UT should remake the FTT's unjustified decision.

The Upper Tribunal considered the arguments of both parties in detail. The Court of Appeal's ruling in *Finance & Business Training* has been handed down since the FTT decision in this case, and it provided a useful and binding explanation of the application of the EU law in this area. The UT should be very careful in overturning a decision of fact in a case about the application of an imprecise legal test: it would be necessary to be sure that there was an error in the FTT's approach.

The UT considered that it was necessary to adopt a multi-step evaluation of the relationship between the supposed "college" and the university:

- first, it would be necessary for both parties to have a common understanding of that relationship – both would have to regard the college as "of the university";
- second, that relationship would have to be of a college and university, rather than some other relationship such as partnership;
- third, the *SFM* factors would be relevant to consider whether the statutory test was met;
- fourth, it would be necessary to consider whether the body supplied education, which was accepted in this case.

The judges considered that the FTT had erred in failing to give proper consideration to the first and second of these tests, without which the *SFM* factors were irrelevant. HMRC's counsel's attack on the conclusions about the relationship between the bodies were well-founded: the status of "associate college" fell below the statutory requirement for a "college of a university". HMRC's appeal was allowed; submissions were invited on the possible consequences of the decision, in particular the action that the UT should take in relation to penalties.

The college appealed to the Court of Appeal, which noted that there were several grounds of appeal, but in particular the UT gave leave in order for the CA to consider the meaning of "college of a university". Patten LJ started with an examination of that expression. In his view, when it was originally used in the FA 1972, it was relatively clear that it referred to the particular traditional collegiate structures of Oxford, Cambridge and Durham universities; he did not accept the college's contention that there had been an intentional widening of the scope of the provision in a minor change of the wording when the VATA 1994 was enacted. However, member states had the power to recognise "organisations with similar objects" under art.132 PVD, so the question was whether the appellant fell within that category. The Court of Appeal had considered the UK statute in some detail in *C&E v University of Leicester Students Union* (2001), and had concluded that the key factor in being "of a university" was that the other entities listed – "colleges, schools, halls, institutions" – had to be part of the university, rather than separate from it (as the union was).

The judge considered the various precedents listed above, and commented that *SFM* appeared to be much more open-ended than the *Leicester Students Union* decision that was issued at around the same time. In his view: "in order to succeed, it must establish that it is what Peter Gibson LJ described in the *Leicester University* case as part of the university in the sense of being a constituent part of the university with all the rights and privileges for its students and other members which that entails. Inherent in that concept is the need to demonstrate some legal relationship between the university and college which establishes and confirms the status of the latter."

The judge examined the facts and the decisions of the two lower Tribunals in detail. His conclusion was that the "special relationship" between SAE and MU was not enough to satisfy what he described as the "harder-edged test" that he considered was required by the law. He clearly considered that *SFM* had been wrongly decided, and had therefore led the later Tribunals into consideration of factors that were not particularly relevant.

The grounds of appeal included the argument that making the exemption dependent on the university recognising the "college" as such introduced a subjective element and therefore contravened the principle of legal certainty. The judge did not agree: this was not a test on its own, as expressed by Judge Bishopp in the Upper Tribunal, but rather an indication that, as a matter of fact, the relationship between the two bodies was not close enough.

The appeal also attacked the UT for overturning a decision of fact based on a multifactorial assessment. The judge held that the FTT had applied the wrong tests, and therefore its conclusion based on those tests could not stand.

Black LJ and Sales LJ agreed, and the appeal was dismissed.

Court of Appeal: *SAE Education Ltd v HMRC*

2.3.4 Effect of *Brockenhurst*

HMRC have added a new page to the VAT Education Manual to clarify the exemption for supplies closely related to education following the CJEU judgment in *Brockenhurst College* (Case C-699/15). The new guidance cancels and replaces R&C Brief 39/2014, and is set out below.

HMRC will apply the judgment in the case to other cases where the facts similarly indicate that the services are not being provided in competition with commercial enterprises. This will be the case where the services are not offered to the general public through advertising, including over the internet, and the costs of providing the supplies to the general public clearly exceeds any income generated from that activity.

HMRC will apply the guidance of the Court on a case by case basis (for example where cases have been stood behind *Brockenhurst*) to decide whether the supplies are exempt as being closely related to exempt supplies of education, or are standard-rated.

There are three main criteria that must be satisfied:

1. The education in question must be being provided by way of business.

Most further education is fully grant funded, and as such is regarded as a non-business activity. If a Further Education College has claims which relate to both grant-funded education and exempt education for fees, HMRC will require the proportion of students whose education is 'business' (i.e. fee-paying, not fully grant funded) in each case. This will vary from one course to another, but is likely to be in the region of 15 – 20%.

2. The activity in question must be student-led and 'essential' to their education.

In the *Brockenhurst* case, both the training restaurant and the theatrical productions were staffed by students, for whom the activity was akin to a classroom. The wording 'essential to the transactions exempted' comes from the mandatory condition in Article 134 (a) of the Directive.

3. The activity must not have the purpose of generating additional income for the body in direct competition with commercial enterprises.

In *Brockenhurst*, the training restaurant only provided meals to those who were on a restricted list, and only recovered 80% of the cost of the food. Hence they were not in competition with commercial enterprises, and were not generating additional income. Claimants must therefore be prepared to demonstrate whether the restaurant (theatre, beauty salon or other activity) is run so as not to generate additional income, and to provide figures which demonstrate this.

VATEDU53400

2.3.5 Local authority sport

A UK local authority reclaimed output tax charged on fees for leisure centres on the basis that they should be regarded as "closely linked to sport or physical education by non-profit-making organization to person taking part in sport of physical education" (art.132(1)(m) PVD). HMRC regarded the application of the exemption as likely to cause a distortion of competition, which will rule out the exemption in accordance with art.133(d). Questions were referred to the CJEU.

A-G Wathelet considered the history of the exemption and its implementation in the UK. Under transitional rules, the UK continued to tax sporting services provided by non-profit bodies (it should have stopped doing so in 1989, but only complied with the law in 1994). It appeared possible for a state that continued to tax such transactions up to 1989 to exclude public bodies from the exemption afterwards; the UK treats non-profit bodies as "eligible" for the purpose of this exemption, but a public authority is not an eligible body within Group 10. The UK's justification for this appears to depend on art.133(d).

The authority argued that this was only available to a country which taxed all sporting transactions up to 1 January 1989; the UK had exempted some such transactions. It also argued that the PVD did not authorise a distinction to be drawn between public authorities and other non-profit organisations providing identical services. In addition, the blanket exclusion of public authorities from eligibility was not related to distortion of competition – that should be evaluated according to the facts of an individual case. The authority emphasised that it was not arguing it was "not in business" – it was acting as an economic operator, but should be regarded as a not-for-profit organisation.

The A-G confirmed that public authorities were automatically within art.132(1)(m), without conditions, in countries that exempted all sporting services before 1989. A country such as the UK that applied VAT to some services was allowed to impose conditions, but the only applicable condition for a public authority was that relating to competition. The A-G pointed out that there is a problem with the UK law: it does not refer to distortion of competition, but simply excludes public bodies from eligibility. He noted that all parties (including the Commission) had proceeded on the basis that the UK law was by implication a use of art.133(d), and gave an opinion on that basis.

The A-G agreed with the UK government that the competition condition could be applied to public authorities by a member state such as the UK that applied VAT to only some, but not all, sporting services before 1989. The local authority's interpretation of the PVD was rejected in this respect.

However, the A-G opined that a member state was not entitled to impose the competition condition on all public bodies but not on other non-profit organisations, as the UK law does. The wording of the Directive was confusing, but the A-G interpreted it as imposing a general requirement to exempt sporting services supplied by public bodies, whereas the UK had effectively interpreted it as allowing an unfettered discretion to exempt such services or not. This conclusion was supported by considerations of fiscal neutrality.

The full court has agreed with the A-G on both these conclusions: as a matter of principle, the UK was entitled to impose the competition condition on public authorities, but could not discriminate between public authorities and other non-profit bodies in doing so. In effect, that means that the local authority has won – for the moment – and the law will have to be revised.

The third of the questions referred asked whether the UK was entitled to apply a blanket exclusion of public bodies from eligibility. The UK government attempted to justify this on the basis of the judgment in *Isle of Wight Council*: it considered that the question of distortion of competition had to be examined at a national level rather than a local level. The A-G agreed with the appellant council that the case was not directly applicable, because it concerned the question of whether the local authority was a taxable person. The appellant accepted that it was a taxable person, but argued that the question of distortion of competition in relation to the exemption had to be considered on a local basis. The Commission supported the UK, arguing that it would not be practical to examine the local market conditions for every operator, but the A-G did not accept this as a valid reason to depart from what the law appeared to require: in his opinion, supplies by a public body could only be excluded from exemption after consideration of the facts of the individual case and whether exemption would be likely to cause distortion of competition to the disadvantage of commercial enterprises subject to VAT.

Because the third question only arose if the second question was decided in favour of the UK (i.e. the UK was entitled to discriminate between public bodies and other non-profit bodies), the full court did not consider it.

CJEU (Case C-633/15): *Ealing London Borough Council v HMRC*

2.3.6 Updated Notice

HMRC have updated their Notice *Postage stamps and philatelic supplies*. The only listed change from the November 2003 version is an updated address for the VAT Reliefs Team.

Notice 701/8

2.4 Zero-rating

2.4.1 Ambulance services

A commercial company provided First Aid training, event medical cover and ambulance services. It had a contract to provide ambulance services to the NHS and purchased several vehicles for this purpose. It reclaimed the input tax on these vehicles on the basis that the supply could be zero-rated under Item 4, Group 8, Sch.8 as "transport". HMRC ruled that the supply was exempt under item 11, Group 7, Sch.9.

Note 4D of Group 8 Sch.8 provides that:

Item 4(a) includes the transport of passengers in a vehicle –

(a) Which is designed, or substantially and permanently adapted, for the safe carriage of a person in a wheelchair or two or more such persons, and

(b) Which, if it were not so designed or adapted, would be capable of carrying no less than 10 persons.

The ambulances were converted from base vehicles that were often converted for other users to carry at least 10 persons. The Tribunal decided that the meaning of the provision was "*to look at the vehicle itself and to determine whether or not that vehicle can, without complete rebuilding, be converted into a vehicle capable of carrying ten or more persons*". HMRC's argument, that it was necessary to consider only how many people could be carried if the wheelchair accommodation was removed, was rejected.

The judge was satisfied that the vehicles satisfied both Note 4D(a) and (b); it had been agreed that sick persons being transported were "passengers". The company could choose between zero-rating and exemption. The appeal was therefore allowed.

First-Tier Tribunal (TC05986): *Jigsaw Medical Services Ltd*

2.4.2 Adjustable beds

A partnership treated supplies of certain adjustable beds and mattresses to nursing and care homes and residents as zero-rated. HMRC ruled that they were standard rated, and raised an assessment for £17,022. A penalty was initially imposed, but the first assessments were withdrawn when it was realised that they had incorrectly been raised on one partner as an individual. The fresh assessment did not come with a penalty.

The dispute was whether the beds were excluded from Sch.8 Group 12 Item 2(b) (electrically or mechanically adjustable beds designed for invalids) by Notes 5B, 5D and 5E. Note 5B restricts the definition of “domestic or personal use” where the individual is an in-patient or resident in a relevant institution, or is attending the premises of a relevant institution. The care homes were relevant institutions. However, Notes 5D and 5H restrict the operation of Note 5B to certain specific types of supply, which did not apply in this case.

The only issue, therefore, was Note 5E:

(5E) Subject to Note (5F), item 2 does not include –

(a) a supply made in accordance with any agreement, arrangement or understanding (whether or not legally enforceable) to which any of the persons mentioned in paragraphs (a) to (g) of Note (5H) is or has been a party otherwise than as the supplier; or

(b) any supply the whole or any part of the consideration for which is provided (whether directly or indirectly) by a person so mentioned.

Note 5H listed persons that included the care homes, but did not include the partnership. The purpose of the provision appeared to be to prevent a care home buying beds (and other supplies within item 2) zero-rated by using the individual as a proxy for the purchase; the relief is supposed to be for purchases by individuals, not by organisations. HMRC argued that the homes were in all cases involved in the purchases, as they had to be because of the siting of the beds in the homes and their involvement in the residents’ care.

The judge examined the underlying facts and concluded that the home was not a party to the transaction. It was involved in too peripheral a manner to trigger the anti-avoidance provision. In contract and in reality, these beds were purchased by and for the individual residents, paid for by them or by their family. If HMRC were right, it would be impossible for any resident in a home to receive a zero-rated supply, in which case the legislation was unnecessarily complicated – if that had been the intention, it could have been achieved much more simply.

The supplies fell within Group 12 and were not excluded. The appeal was allowed.

First-Tier Tribunal (TC05957): *Ashworth Trading*

2.4.3 Updated Notice

HMRC have updated their Notice *Zero-rating young children's clothing and footwear*. References to ‘mixed’ supplies have been replaced with ‘single or multiple’ supplies, to be consistent with other HMRC publications.

Notice 714

2.4.4 Cars for disabled persons

In an article in *Taxation*, Kelly Sizer reviews the changes to the conditions for zero-rating of cars for disabled persons, that have been introduced to prevent abuse of the relief by “recycling” cars over a short period.

Taxation, 3 August 2017

2.5 Lower rate

Nothing to report.

2.6 Computational matters

2.6.1 Intra-group transactions

In TC04840, the FTT largely upheld the appeals of two connected companies against the issue of a Sch.6 para.1 direction requiring transactions between them to be accounted for at open market value, and a ruling that the standard method override applied to reduce input tax recovery. The VAT assessed as a result of the direction was £4.25m for the periods concerned, and the override adjustments were nearly £600,000 over two years. HMRC have failed to overturn those decisions in the Upper Tribunal.

The two companies (TFL and TRL) were separately VAT-registered fellow subsidiaries of a UK holding company (PerfectHome). The precise nature of their respective activities was disputed, and the Tribunal had to make findings of fact. The group as a whole operated from 67 showrooms located in various parts of the UK. It sold household goods, furniture and electronic appliances to consumers. Its customers were generally unable to use credit cards; 98% of its sales involved hire purchase, with the customers making weekly payments, typically over three years. Customers often purchased insurance and extended warranties as well as their goods.

Some 40% to 50% of customers terminated their HP agreements early. The company tended to repossess goods rather than taking legal action against the customer. Goods were refurbished and resold.

The business of the group was carried on by the two companies acting in accordance with an "intra-group services agreement":

- TRL was the tenant of the leasehold showrooms;
- TRL bought advertising services;
- TRL bought goods for resale, and in the 2% of sales that were for cash, was the only group company involved in transactions with the customer;
- in relation to HP sales, TRL sold the goods to TFL for 97% of the advertised price (standard rated);
- TFL entered into the HP contract with the customer and treated 100% of the advertised price as its standard rated sale;
- TFL entered into the contracts for insurance and extended warranties;
- TFL paid TRL for delivery of some bulky items to customers (a standard rated service).

TRL was a fully taxable business for VAT purposes. TFL was partially exempt. HMRC were concerned that this provided the opportunity to manipulate the VAT recovery of the group as a whole. On 31 May 2012, an officer issued a direction to TRL requiring market value to be applied to supplies of shop advertising and launch costs in relation to the stores from 1 June 2009 until the direction. The assessments were issued in June 2013 and May 2014 on the basis that HMRC were not satisfied that the company had complied with the direction.

HMRC considered that OMV of the intra-group supplies should be calculated as follows:

- costs associated with the stores should be split 25% to TRL and 75% to TFL, and recharged by TRL to TFL with a 10% mark-up;
- advertising costs should be split in the ratio of cash and HP sales (2:98), and again recharged by TRL to TFL with a 10% mark-up.

HMRC also considered that the standard method was unduly favourable to TFL, on the grounds that have been applied to other HP companies – including the selling price of the goods significantly increases the taxable turnover in relation to the "real" income of the company, which HMRC consider to be the exempt finance charges and insurance commissions.

In the FTT, Judge Richards considered that the burden of proof lay on the companies to demonstrate that the directions should not have been issued. The Tribunal had a full appellate jurisdiction to substitute different figures for those used by HMRC, if it considered that the supplies were indeed made at below market value.

He went on to examine the UK law and its basis in art.80 and art.72 PVD. Before applying them to the facts, he commented on an objection raised by the taxpayers' representative that use of the words "artificial" and "contrived" in HMRC's statement of case were prejudicial and tantamount to allegations of dishonesty, that ought to have been more specifically pleaded and raised at an earlier point in the proceedings (the SOC was filed four days late). The judge rejected these objections, holding that they were relevant arguments and implicit in the basic assertion that the transactions were at less than OMV.

The judge also had to consider objections by the taxpayer to the admission as evidence of an All Party Parliamentary Group on the PerfectHome business (objection overruled) and by HMRC to the admission of transfer pricing reports prepared by Grant Thornton. HMRC argued that GT were not independent (as they were advising the companies in the appeal) and their reports were irrelevant, because they were based on OECD guidelines rather than the principles of OMV for VAT. The judge said he would admit their reports as evidence, but as they were not prepared for the Tribunal itself, they would not be given the same weight as expert witness statements.

The judge then examined the way in which the two businesses operated, both with customers and with each other. He concluded that they were separate businesses, but commercially intertwined. PerfectHome was set up to deal with credit-constrained customers in particular, and was not operating in the same marketplace as other retailers of similar goods. The judge analysed and listed out what he regarded as the activities of each company.

HMRC argued that TFL was the "primary" user of the stores, because 98% of the customers bought on HP terms. The judge agreed with the company's finance director that this was the wrong way of looking at the business. Customers came to the stores seeking to buy goods, not finance.

HMRC further argued that the present owners of PerfectHome had bought it as a single company, and had divided it into two businesses with the object of reducing the irrecoverable VAT by making intra-group supplies at less than market value. The finance director denied this, claiming that there were various commercial reasons for the two-company structure. HMRC's representative pointed out that the two-company structure created irrecoverable VAT on certain recharged costs, and argued from this that "the savings elsewhere must have been greater in order to justify this inefficiency". The judge did not accept this either. In his view, VAT savings were not the motivation for the two-company structure.

HMRC's representative asked the group tax manager if he had ever disclosed a tax avoidance scheme. He said that he did not believe he had. The following day, HMRC's representative told the judge that HMRC had evidence to suggest that this was not true, but taxpayer confidentiality prevented them producing that evidence to the Tribunal. The judge declined to recall the witness and explicitly accepted his evidence.

The Sch.6 para.1 direction applies to supplies that are made for less than their OMV. HMRC argued that some supplies were made from TRL to TFL for more than their OMV – in particular, the supply of the goods. This would not lead to any irrecoverable VAT (because it would be directly attributable to the onward taxable supply of those goods), and was to compensate TRL for undercharging in other areas. HMRC considered that TRL should be regarded as a "wholesaler" in respect of these goods. The judge did not accept this. TRL was not a wholesaler; the *VW Financial Services* appeal showed that it was normal for a HP finance company to buy goods at 100% of the retail price.

An argument about recharges for repair services was also rejected. HMRC's calculations of the "mark-up" on those repair services omitted the most substantial cost of TRL in providing them – the cost of staff carrying out the repairs, which would not generate any irrecoverable VAT. Delivery charges, where TRL charged 5% of the price to TFL but TFL did not charge the customer, were part of the overall commercial activity of TFL, and should not be looked at in isolation. The judge was satisfied that TRL did not overcharge TFL for any of the inter-company transactions, so that there was no inference to be drawn that a compensating undercharge arose on other supplies.

The judge then examined in detail the professional advice that the companies had received from GT and from a consultant about inter-company charges. He approved of the approach GT adopted to the calculation of "store charges", and disapproved of HMRC's approach; in his view, the actual charges might be argued to be lower than "at the high end of the range" suggested by GT, but that did not mean they were below OMV.

The judge was less satisfied with GT's approach to the charges for advertising, preferring HMRC's conceptual analysis. However, HMRC's application of its analysis ignored the fact that TRL made a retail sale with a 37% mark-up every time TFL made a sale. Their calculation of the OMV was therefore wrong. He set out how he considered it ought to be done; presumably the parties will go away and recalculate the results.

The standard method override (SMO) argument was significantly affected by the 2015 decision of the Court of Appeal in *VWFS*. Although that had been about the proposed imposition of a special method on a HP finance company, it nevertheless cast light on the question of what such a company's overheads were "used" for. For the same reasons as the Court of Appeal, the judge considered that TFL's business consisted in selling both taxable goods and exempt services, and its overheads were consumed in making both supplies. The SMO did not apply.

The end result was that the appeal was allowed in part: the SMO was not appropriate, and store fees should not be included in the Sch.6 para.1 direction. The advertising recharge was in principle subject to the direction, but the amount involved should be recalculated.

Upper Tribunal

HMRC's appeal came before Judge Greg Sinfield and Judge Sarah Falk. HMRC put forward 8 grounds:

Ground 1: the FTT failed to apply the principle of fiscal neutrality.

Ground 2: there was inadequate reasoning to support the FTT's erroneous finding that TRL and TFL carry on separate businesses.

Ground 3: the FTT made an irrational or erroneous finding that there is a "shop within a shop" arrangement between TRL and TFL, with TFL acting as a concessionaire.

Ground 4: alternatively, the FTT took an irrational approach to the assessment of the appropriate "concession fee".

Ground 5: the FTT's approach to determining the OMV of advertising services was flawed.

Ground 6: the FTT misdirected itself in the approach to be taken to determining TFL's recoverable input tax on its overheads (the partial exemption issue).

Ground 7: the FTT erred in deciding that the standard method for determining the proportion of input tax recoverable on TFL's overheads was fair and reasonable.

Ground 8: the FTT erred in its decision in respect of "quality refurbished" or "QR" goods, the value of which should have been excluded in TFL's partial exemption calculation.

The judge reviewed the operation of the business, the law, and the basis of the FTT's decision, before considering each of these grounds in turn. He noted that HMRC's arguments had a recurring theme: their starting point was to compare the VAT treatment of the companies as contended for by the taxpayers, with what the treatment would have been of the PerfectHome business carried on by a single company. It was noted that they could not succeed on both the Sch.6 para.1 and SMO arguments, because that would actually create a situation worse than the "single company" arrangement. HMRC also did not argue that the arrangements were abusive in a *Halifax* sense.

The first two grounds were dismissed. Fiscal neutrality is a principle of interpretation, but it had no application here. HMRC sought to compare the treatment of two businesses not with two identical businesses carrying out competing transactions, but with a different and hypothetical situation. That stretched the principle further than was possible. There were, as a matter of fact, two separate taxpayers, which meant that there had to be two separate businesses. This was supported by the decisions in *Lower Mill Estate* and *Telewest Communications*, and there was no principle of law that permitted HMRC to recharacterise these genuine arrangements as anything other than what they were.

The FTT's conclusions on "shop in shop" arrangements and the concession fee were open to it on the basis of the evidence presented. HMRC's argument that TFL should take 98% of the advertising cost ignored the crucial factor that TRL made a 37% profit margin on every TFL sale, which was a critical flaw in their contention that the benefit of advertising was so heavily weighted to the financial business.

As regards the approach to the SMO, the judge noted the comments of Lord Carnwath in the Supreme Court in *VWFS*. Where the parties are substantial litigants represented by experienced counsel, the tribunal is entitled to assume that the parties will have identified with some care what they regard as relevant issues for decision. The FTT was therefore entitled to consider simply whether the method put forward by TFL was preferable to HMRC's proposal, or the other way around; it was not required to consider whether there might be a better alternative. HMRC's arguments also did not take sufficient account of the fact that the standard method is the default, with any departure from it requiring exceptional circumstances.

The judge quoted from the CA decision in *VWFS* at length, and came to the same conclusion: it was unreasonable of HMRC to allocate none of the company's overheads to the sale of goods, when its transactions were heavily dependent on the sale of goods. There were substantial costs associated with those supplies, including the collection of instalments of the consideration. The SMO, which depends on the "use" of the overhead inputs being significantly different from the turnover-based allocation, was not applicable.

The eighth ground considered a detail of the calculations in relation to refurbished goods, and was again rejected. HMRC sought to rely on the case of *Regie-Dauphinoise* to establish a general principle that certain distortive transactions should be excluded from the overhead recovery calculation; but this is governed by SI 1995/2518 reg.101(3), which had no application here. In any case, the sales process for these goods was almost identical to that for new goods, which suggested that there was no distortion.

HMRC's appeal was dismissed in its entirety.

Upper Tribunal: *HMRCv Temple Finance Ltd and another*

2.6.2 Calculations

In TC05257, 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 FTT 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 considered 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.

HMRC appealed to the Upper Tribunal, arguing that the FTT judge had erred in his interpretation of the legal provisions, in particular in relation to “decrease in consideration”. HMRC continued to maintain that the amount paid by the customer had not changed, so there could be no “decrease”. There were in total 8 different grounds of appeal.

The Upper Tribunal ruled that HMRC’s arguments were misconceived. The focus of the VAT legislation was on “consideration for the supply”. The single payment from the customer did not change, but the amount of it that constituted consideration did change. The company had not made a mistake when using a lawful method of apportionment on the “game” basis, and was acting properly when instructed to change to a different lawful basis; HMRC had invited retrospective claims by reference to s.80, but that did not prevent the taxpayer from making any other lawful claim, including one under reg.38. An argument that the FTT should have regarded the “session payment” as a “single supply” was rejected because, once again, the focus should have been on consideration, not supply.

The FTT had come to the correct decision, and HMRC’s appeal was refused.

Upper Tribunal: *HMRC v K E Entertainments Ltd*

2.7 Discounts, rebates and gifts

Nothing to report.

2.8 Compound and multiple

2.8.1 Opticians

A dispute arose concerning the apportionment of the single charge made by an optician for dispensing and supplying spectacles. HMRC have accepted, since the *Leightons* decision, that this is a mixed supply of exempt medical services and standard rated goods; however, arguments arise about the correct apportionment, given that no split is usually disclosed to the customer.

HMRC raised an assessment for £41,444 covering the periods 08/11 to 02/15 on the basis that 54% of the charges were standard rated. The company argued that it had a binding agreement in place that the proportion should be 44%, and even if it did not, the basis of the HMRC calculation was flawed.

The 44% figure had been given to the trader in 1996, but it was supposed only to apply up to 31 August 1997, with a review to take place by 28 February 1998. No review ever did take place, and the first VAT visit was in 2014, resulting in a retrospective assessment covering 4 years.

The trader relied on the 1996 letter as an agreement made under reg.67, which the FTT agreed would bind HMRC and could not be retrospectively changed. However, the FTT did not agree that the letter gave the trader the right to rely on 44% without time limit – the letter clearly stated that it only applied to the end of August 1997. The fact that

HMRC continued to accept the VAT returns without objecting to them could not be taken as positive acceptance. It was not unreasonable for HMRC to go against what they had agreed for a limited period in a letter 18 years earlier.

The FTT then examined the proper apportionment of the consideration. It was agreed that the calculation should be based on the formula:

(cost of spectacles etc ("COS")) / (COS + cost of dispensing ("COD")

There was agreement on COS, but not on COD. It should be the employment cost of the company's staff who were involved in dispensing, but that was subject to dispute. The Tribunal therefore considered the activities involved in dispensing spectacles, as set out by McCullough J in *Leightons*. It went on to examine the different ways of calculating the employment costs and apportioning them between exempt and other activities, which included a large number of arguable percentages. For example, it was possible to apportion the cost of ophthalmic opticians either in proportion to the time they spent on different activities (which included wholly exempt eye tests) or in proportion to the revenue earned in the company's accounts. The judge considered that a time-based apportionment was appropriate, and that time spent on abortive dispensing (that did not result in a sale) should be built in to the calculations because it was an economic cost of the business.

There were specific conclusions such as that an ophthalmic optician would spend 12 minutes of a 30-minute appointment on the eye test and 18 minutes on dispensing activities, so 60% of that time would be part of COD. There were estimates for the time spent by the proprietors on running the business, and time that was non-productive and therefore not involved in dispensing.

The judge did not formally determine the appeal, but set down various "dispensing percentages" for individual employees. The effect of those percentages was left to the parties to agree.

First-Tier Tribunal (TC06011): *Megji & Co Ltd*

2.8.2 Separate supplies?

A trader asked for a reconsideration of a decision issued on 25 May 2016. HMRC did so and issued a new decision on 19 July 2016, which was confirmed on review on 9 September 2016. The trader appealed to the Tribunal. Judge Anne Scott noted that the trader's representative had objected in correspondence to the fact that HMRC had changed their original decision. She considered this entirely proper, given that the main issue had not been raised up to that point.

The company supplied driving instructor training courses in three parts. Customers paid for the whole course up front, but might not commence or complete all of the modules. The company claimed repayment in respect of payments that had been treated as VATable when no supply had in fact been made.

The taxpayer wrote to HMRC on 7 April 2016, asking for approval of its proposed treatment of such "no shows". In effect, it wanted to treat the payments in the same way as forfeited deposits for hotel rooms: they would be VATable at the time they were received, but the failure of the customer to take up the course at the right time would lead to forfeiture and cancellation of the supply. The trader relied on the cases of *Air France* and *Esporta*; HMRC responded that these were irrelevant, and that the *NCP* case on overpayments supported their view that the whole payment was taxable.

At the hearing, the company argued that each part of the course was discrete and separate. Each part was supplied by a different person, so it could not be amalgamated for VAT purposes. The consideration had to be objectively linked to the supply that was given.

HMRC responded simply that the tax point for the supply was fixed at the time the payment was made, and the failure of the customer to take advantage of what had been paid for did not change the VAT treatment.

The judge cited the following principle from *SecretHotels2*: “When interpreting an agreement, the court must have regard to the words used, to the provisions of the agreement as a whole, to the surrounding circumstances insofar as they were known to both parties, and to commercial common sense.” She also noted from *WHA Ltd v HMRC* that “decisions about the application of VAT are fact sensitive and a small modification of the facts can render the legal solution in one case inapplicable to another. It is therefore necessary to consider the facts and all the circumstances in which the transaction took place carefully before looking at the matter as a whole in order to determine its economic reality. The contractual position is not conclusive of the taxable supplies being made as between the various participants … but it is the most useful starting point.”

The judge examined the contracts that the appellant company entered into. The courses were promoted to potential customers by the appellant under the trading name “RED”, but part 1 of the course was supposedly supplied by a different group company, which had no staff, only holding intellectual property rights for bespoke RED software. The customer’s fee was regarded as 20% for part 1 of the course, 20% for part 2 and 60% for part 3. The other company was paid the first 20% when the course commenced, and accounted for output tax on it (it was not part of a VAT group registration with the appellant).

The judge questioned whether the “two company” approach represented commercial reality. The second company owned IP that was apparently used for part 3 of the course as well as part 1, but did not receive any payment for part 3. That suggested that there was in fact a single supply.

The main problem with the taxpayer’s argument, though, was with the hotel analogy. The customer would know from the agreement that there was a risk of forfeiture of fees if the course was not completed in time. The proper parallel was with a prepayment for a guaranteed hotel room where the customer did not turn up; it was not a forfeited deposit, but a payment for a service that was not pursued. The customer was supplied with the right to embark on all three parts of the course, each of which was integral to the course as a whole. It would be artificial to split the supply. Although there is no explicit finding that the arrangements between the two companies were an artificial attempt to split the supply, it is implied by the conclusion that there is a single supply that cannot be divided.

The appeal was dismissed.

First-Tier Tribunal (TC06087): *RDS Driving Services Ltd*

2.8.3 A package deal?

Two companies supplied packages of allowing a child to hire skates and skate on its ice rinks. The hire of skates to a child would be zero-rated; the question was whether any part of the package deal could be zero-rated.

HMRC had picked up the fact that the companies were not charging VAT on all supplies from their VAT returns, and wrote to enquire whether this related to the hire of children's skates. The first company confirmed that it was, and pointed out that this was standard industry practice; the company's adviser pointed out that Public Notice 714 para.9.3 supported the treatment. The officer replied with an analysis of "single supply indicators" and "multiple supply indicators", and concluded that the present case should be treated as a single standard rated supply. The resulting assessment would be £641,601 (later amended to treat the receipts as VAT-inclusive). A similar process with the other company led to an assessment of £52,783 including interest. "Deliberate conduct" penalties were threatened.

The Tribunal examined the way in which the rinks operated, and noted that different prices were charged to people with and without skates. A survey suggested that 45% of users had their own skates, while nearly 55% did not.

The company put forward a number of arguments that the supplies were separate. Neither supply was predominant and neither was ancillary. The pricing clearly distinguished between the two elements. There was also an argument that the *Talacre* principle might apply to a single supply in this area – that even a compound supply could be partially taxed at the zero rate.

HMRC put forward three propositions, with detailed points to support each one:

- multiple services including skate hire are advertised as a package and customers pay a single price;
- for typical customers skating is their aim;
- the supply of ice skates is integral to the use of the ice rink.

The *Morrisons* decision (on barbecues) should be applied – there was no good reason to carve out the skate hire, when it was an integral part of a single supply.

Judge Richard Thomas started his "discussion" with the following comment:

Unlike many VAT cases on the general issue of single and multiple supplies, this case was mercifully free of great long lists of European and domestic authorities. This is the correct approach because, as we have been told by Lord Hoffmann everything starts with CPP, and with the exception of Levob and maybe a domestic case or two, everything ends there.

After a review of those precedents, the judge concluded that this was clearly a situation in which there were separate elements of the package. It was not artificial to split them. Unlike the situation in *CPP* or *Levob*, significant numbers of customers bought one element of the package without the other. Therefore it made no sense to say that the elements were not dissociable when on a majority of the occasions that users entered the reception to use the rinks they chose only one of the two main elements, entry to the rink.

The appeal therefore succeeded, but for completeness the judge considered the "fallback" argument based on carving out an element of a compound supply. He agreed with HMRC that *Morrisons* and *Colaingrove (fuel)* applied: explicit words would be required in the law to give that result, and they were not present. The second "fallback" argument, based on fiscal neutrality, was not considered because the judge did not think he had sufficient evidence to reach a decision.

The judge made the following highly critical comments:

118. We were not asked to consider whether the assessments made in this case were in fact made to the best of Mr Merson's judgment. But we find it decidedly odd that following a VAT inspection and meeting with the management of PIB in 2012 after which he took policy advice and approved their zero-rating the hire of skates, he later reversed that decision, apparently because of the issue by HMRC of revised guidance to its staff about CPP (which had been heard years before) – see §14.

119. Even odder was the decision to apply this guidance (or to have it applied by specialists for him) to the companies in this case without any attempt to discover whether there were any differences between PIB's operations and that of the appellants and without visiting their operations or talking to their management. Indeed all he asked the appellants was whether their exempt or zero-rated sales covered children's ice skates, and on the basis of their confirmation he justified his assessments.

120. That the text of his letter to IRC was simply cut and pasted can be seen from the initially puzzling reference to PIB's future conduct in it – see §17.

121. Mr Merson also seems to have confessed that his figures in his assessments were obviously wrong.

122. We also do not understand why PIB and possibly other cases in common ownership were not able to convince HMRC that it would cause them hardship to pay the VAT demanded, but the appellants could.

123. Nor do we understand why if HMRC changed their view of CPP etc in 2012 or 2013 they felt it appropriate to assess large amounts (over £600,000 in IRC's case) going back four years: obviously they had the statutory right to, but that should not necessarily the be all and end all.

124. Finally to threaten Schedule 24 FA 2007 penalties on the basis of what Mr Merson knew (or did not know) when he threatened them was not, to our minds, the action of a reasonable VAT officer.

In spite of the reference to unreasonable conduct, the judge did not suggest that the taxpayer should apply for, or would be entitled to, costs.

First-Tier Tribunal (TC06117): *The Ice Rink Company Ltd and another*

2.9 Agency

2.9.1 Updated Notice

HMRC have updated their Notice *Travel agents and tour operators*. The only listed change since the March 2002 version is updating of contact information for HMRC's customs and indirect tax directorate.

Notice 709/6

2.10 Second hand goods

Nothing to report.

2.11 Charities and clubs

Nothing to report.

2.12 Other supply problems

2.12.1 Toolkits

HMRC have as usual updated the toolkits that are intended for agents to use when assessing the reliability of a client's systems for producing accurate VAT returns. They are a good guide to the risks of error that may arise, but the practicality of using them as an external VAT adviser is questionable. They are likely to be very useful for internal auditors.

HMRC Toolkit: *VAT Output Tax (2017)*

The *Business Profits* toolkit includes the note "*It is also important to ensure that where the turnover exceeds the prescribed registration thresholds that the business registers for VAT. Where a business is registered for VAT the accounts and returns should normally include sales and purchases net of VAT.*" However, self-assessment returns offer as an alternative the preparation of accounts using VAT-inclusive figures, and treating net VAT payments as an expense.

HMRC Toolkit: *Business Profits (2017)*

2.12.2 Loyalty points

The Tesco Clubcard scheme includes a feature whereby customers can obtain vouchers that are used to buy goods and services from third parties. The third parties are then paid by Tesco for making the supply. The company claimed input tax deduction in relation to the payments made to third party "redeemers", and HMRC refused, ruling that this was third party consideration for a supply made to someone else (the customer).

Assessments and decisions affected some £166m of input tax incurred between 1 September 2002 and 25 February 2017.

The judge (Colin Bishopp) reviewed the operation of the scheme, and accepted the evidence of the company's witness that it involved no element of bounty: it cost the store several hundred million pounds a year to run, and the only purpose of incurring that cost was to promote the business. The cost of the scheme was one factor built into the price of goods offered for sale.

The judge went on to examine the agreements between Tesco Freetime and "deal partners", under which third parties would make supplies in return for Clubcard rewards vouchers. He quoted at length from the Supreme Court decision in *Loyalty Management UK* (*Aimia*), which concerned very similar arrangements and arguments.

HMRC's argument was that the customers paid nothing for the points they received, and what Tesco paid to third parties was third party consideration for a supply to the customers. They argued that the contracts should not be looked at on their own, but examined in the context of the "economic reality" of the situation as a whole. This was particularly important where, as here, the contracts were equivocal on the question of who was supplying what to whom.

After 73 preliminary paragraphs, the first comment under "discussion and conclusions" is:

I have laboured, I regret for too long, to reconcile the competing requirements that I must pay heed to the contractual position, to the economic reality of the facts as I find them to be, and to prior authority; and I have been puzzled by the extent of that authority. The arguments in this appeal occupied four days of tribunal time, and resulted in several rounds of submissions and responses after the hearing had concluded. Those factors have caused me to wonder, both during the hearing and thereafter, whether there is some complication to loyalty schemes such as the Clubcard scheme which has escaped my notice since, try as I might to find that complication, I have failed. Rather, it seems to me that the VAT analysis is in truth both simple and straightforward once one puts aside some misconceptions and understands how the scheme works.

HMRC had argued that Judge Bishopp should ignore the Supreme Court's judgment in *Loyalty Management* because, as Lord Carnwath had pointed out, the CJEU seemed to uphold HMRC's case. The judge responded that the majority in the Supreme Court had clearly been aware of the objection and had overridden it; he was bound to follow them.

He also considered that HMRC's presentation of the economic reality was "demonstrably false". The customer was not getting "something for nothing", and there was no untaxed consumption. The precedent on which HMRC extensively relied, *Kuwait Petroleum*, contained a difficult paragraph that appeared self-contradictory; the judge felt able to ignore it because the loyalty scheme in that case differed in several respects from those that have come afterwards.

The judge spelled out in some detail his view that some element of what the customer pays for "premium goods" (i.e. earning points) is used to pay for the redemption supply. The customer therefore bears the burden of the cost of both supplies, and also bears the tax on both supplies. The amount paid by Freetime to the deal partner was not "new money injected into the arrangement" that would result in untaxed consumption if Freetime was allowed input tax recovery; it came from the customer's fully taxed initial purchase of premium goods.

The company's appeals were allowed.

First-Tier Tribunal (TC06050): *Tesco Freetime Ltd and another*

2.12.3 Unused credits for supplies not taken up

A company offered access to genealogical websites which it owned or in respect of which it held licences. Access could be by way of a subscription, which lasted for a certain period, but which was not otherwise limited as to use. Alternatively the sites could be accessed by a Pay As You Go system ("PAYG"): a lump sum was paid, for which a number of units or vouchers giving opportunities to download information were issued, and which had to be used up within a certain time.

The company reclaimed output tax on unused PAYG credits for the period from 09/08 to 10 May 2012. It argued that there had been no taxable supply and therefore no liability for output tax. The claim totalled £434,000. On 10 May 2012 the law changed with respect to the issue of "single purpose vouchers" to make it clear that the time of supply fell on issue, not on redemption.

The appellant argued that the face-value voucher rules before that date should have been applied: there should have been no tax point on issue of the PAYG "vouchers", but rather VAT should have been accounted for on use.

The FTT (TC04133) agreed with HMRC that in reality the company supplied a package of services that was taxable at the time of purchase, and it was not possible to separate out any unused element that should be treated as subject to the FVV rules. The documents issued by the company were in reality simply receipts, not vouchers for redemption. A number of other precedents, including *BUPA*, were considered, but none helped the company in its efforts to delay the tax point.

Upper Tribunal

The company appealed to the Upper Tribunal. The judge set out a number of key issues to be determined. First, there was a difference between the parties' views of what was supplied by the appellant:

- the company argued that it supplied the genealogical records viewed or downloaded by the subscriber – until the subscriber did that, there was no supply;
- HMRC argued that the customer acquired a "package", which afforded him the facility to take advantage of the work done by the appellant in gathering and publishing information – the package was supplied as soon as the credits were purchased.

The appeal would fail if HMRC were correct about the nature of the supply. The appellant also needed to sustain an argument that either:

- the PAYG credit was a face-value voucher within Sch.10A para.1(1); or

- the PAYG credit was not a prepayment for the service provided by the appellant, capable of advancing the tax point to the time of receipt.

The company argued that it was like a virtual bookshop. The search facilities on the website were ancillary services, whereas the downloading of documents was the principal supply. What the customers were paying for was the downloading of specific documents that they selected as relevant to them. It would be artificial to regard anything else the company did as a separate supply or as changing the nature of that supply into some different kind of "package".

HMRC relied on the *Lebara* decision in support of the contention that the PAYG credits were a prepayment for access to a facility, taxable at the time that payment was made. There was a clear contract setting out the terms, which included the fact that refunds were only possible within 7 days of payment, and then only if no documents at all had been downloaded. The search functions were an essential part of the package that the customer was paying for, because the publication of the documents would be useless without them.

The judge considered that the FTT's findings on the nature of the supply, which had agreed with HMRC's view, were inconsistent with the company's contracts. The judge noted that the FTT decision did not reproduce the company's contracts (which he did), but was clearly based on them. The findings about the nature of the supply were decisions of law based upon findings of fact about what the company did.

The judge did not agree with the conclusions. The search function was free: it was not necessary to buy PAYG credits to enter the website and search for documents. A customer could search for as long as he liked, find the documents that he wanted, and then buy PAYG credits only to download them. It followed that the search functions were not part of any "package" paid for by the customer, even though a customer might use the search functions after buying credits. It would not be artificial to split the search function and the downloading of documents into separate supplies (one free, one paid for): that reflected the reality. It also reflected the link between the payment and the service that was supplied in exchange.

The judge went on to consider whether the credits satisfied the definition of "face value voucher" in Sch.10A. In his view they did so. Although the monetary value was only recorded in the records of the company, it was clear enough that the credits reflected a monetary value that had been paid for them. They gave the right to receive services up to that value, and the value was recorded in the records of the company in order for the company to know what it was obliged to supply. The FTT had rejected the appellant's argument on this point because it did not think that the customer would be readily able to translate credit units into money, but the UT judge disagreed. He considered the precedent cases of *Leisure Pass* and *Skyview Ballooning* supported the treatment of these vouchers as FVVs.

The FTT had also decided that the credits were prepayments for the services, which meant that a tax point was fixed. The nature of the services was known, so the *BUPA Purchasing* decision did not apply. Again, the UT judge did not agree. It was possible for the company to change the price for downloading documents – the amount of credits required could be increased or reduced. That meant that the purchaser of credits could not be certain of the documents that could be accessed for a particular amount of credits. The services to which the customer was entitled were not clearly identified at the time of purchase. It only became fixed when the documents were identified and the credits used.

The appellant therefore succeeded on all the points – the supply was that of downloading documents, not a "package"; the PAYG credits were FVVs; and even if they were not FVVs, they were not prepayments that were capable of fixing a tax point.

Court of Session

HMRC appealed to the Court of Session. The judges considered in detail the nature of the service provided by the taxpayer, and concluded that it was the provision of the documents – that was what the customer wanted and was prepared to pay for. The search function was merely ancillary, because it did not provide the information that someone researching their genealogy would want: it only provided an indication that a document might be relevant. The court agreed with the UT that the free access provided to the public meant that the search function was simply not something the customers paid for.

The question of a prepayment creating a tax point was also considered. The court again agreed with the UT: there was too much uncertainty at the time the payment was received, as to the timing, chargeability and even the occurrence of a chargeable event, for the payment to be treated as a prepayment for a specific and identifiable supply. There was therefore no direct and immediate link between the payment and the intended supply, and no tax point.

That was enough to decide the case in the taxpayer's favour, but the court also gave its views on whether the credits constituted face value vouchers (FVV). The judges contrasted various features of this business with standard FVVs such as book tokens: for example, it was only possible to access services using the credits, rather than paying with a mixture of credits and own funds; the credits were not transferable, and could not be used anywhere else. The court held that the credits did not satisfy the conditions of para.1(1) Sch.10A in that they did not themselves disclose their face value – that required access to the records of the company, and the possibility of fluctuations in value meant that they did not represent a right to receive services "to the value of an amount".

HMRC's appeal was dismissed.

Court of Session: *HMRC v Findmypast Ltd*

3. LAND AND PROPERTY

3.1 Exemption

3.1.1 Immovable property

In TC05253, 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 FTT 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 contained 19 classrooms, staff and office accommodation, toilets, stores and ancillary accommodation, an internal lift and lift shaft, and internal staircases. 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 FTT 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 FTT 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.

HMRC appealed to the Upper Tribunal, which reversed the decision. The issue was in relation to the UK law (“grant of any interest in or right over land or of any licence to occupy land”), to be construed in accordance with the EU law (“letting of immovable property”, defined as “a building fixed to or in the ground”).

The UT derived a number of principles from the precedents:

- exemption would follow if there was a letting of something immovable, which meant fixed to or in the ground, and there was no exhaustive definition of how that should be interpreted – rather, it should be interpreted after an objective consideration of how the structure related to the site;
- the two main precedents, *Maierhofer* and *Leichenich* (Case C-532/11), did not support the consideration of individual components in the overall structure, nor a sequential approach considering each step in the process of construction and dismantling separately. Rather, all aspects of the structure should be considered together.

The UT concluded that the FTT had misdirected itself as to the law, and failed to apply the law properly to the facts. It had arrived at conclusions that no reasonable FTT could properly reach. The building had substantial foundations set in the ground. It was fixed to the ground not only by the connection to utilities and the fire escapes, but also by its own very substantial weight. Moving it involved dismantling the structure, which would effectively make it no longer a structure – it could not be “moved” without changing it fundamentally.

The UT allowed HMRC’s appeal and remade the decision, holding that the original ruling for exemption was correct.

Upper Tribunal: *HMRCv Sibcas Ltd*

3.2 Option to tax

Nothing to report.

3.3 Developers and builders

3.3.1 Personal care redefined

HMRC have revised their policy on the definition of ‘personal care’ for the purposes of deciding when a new building can qualify for zero-rating as a care home, or is treated as a standard-rated hospital. Following the 2016 FTT decision in *Pennine Care NHS Trust* (TC04998), HMRC accept that besides providing for lengthy periods of residence, ‘personal care’ in a care home may also involve a high level of medical treatment.

The point at issue is whether the treatment centre is regarded as “solely for use for a relevant residential purpose” (eligible for ZR) or excluded from ZR by being “similar to a hospital”. A “care home” is RRP: it provides residential accommodation with personal care to people in need of such care because of old age, disability, past or present dependence on drugs or alcohol, and past or present mental disorder. The Brief points out that calling something a “hospital” will not exclude it from zero-rating, provided that it actually serves the purpose of a care home.

The Brief also sets out the following comparison of hospitals and care homes:

Hospitals	*Care homes*
Aim to treat patients quickly then discharge them to make space for other patients needing treatment.	Allow lengthy periods of residence for individuals suffering from conditions that need longer term care.
Deal with injuries, illnesses and conditions that need medicinal or clinical intervention and rely on staff with the appropriate qualifications to carry out these functions.	Provide personal care that tends to be for the purpose of enabling a person to look after themselves.

In *Pennine Care NHS Trust* the FTT held that ‘personal care’ is a term that must reflect current times; it may go beyond the basics of feeding and washing and in the Tribunal’s view, in the context of mental health illness, the inclusion of the type of bespoke and specialist care provided by the Unit did not trespass into the arena of a ‘hospital or similar institution’.

Personal care may incorporate a high level of medical treatment if it’s essential to the accommodation that’s being provided. Care homes, as distinct from hospitals, may be set up to offer an extended period of in-house treatment or to offer treatment that assists recovery or rehabilitation.

A care home may have a treatment centre that occupies a building, or a distinct part of a building. The treatment centre will be subject to zero rating if it’s to be used solely for the residents of the care home, interpreted as used 95% or more by those residents. If it’s used more than 5% by non-residents of the care home, the zero rate won’t apply to its construction or first grant of a major interest.

The decision in *Pennine* was in the specific context of care provided for persons detained under the Mental Health Act 1983 (misprinted in the Brief as “Medical Health”). HMRC accept that the approach adopted by the FTT will apply to other institutions (such as hospices) which allow for a longer period of convalescence or rehabilitation than would commonly be the case in a hospital.

Businesses may be able to recover VAT paid on supplies which would have been eligible for zero-rating under the revised policy, subject to the four-year limit on claims. The business running the care home will have suffered the VAT, but it will in the first instance be the supplier (the developer or builder) who has to make the claim and refund the overcharged VAT to the care home.

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3.3.2 Pub conversions

The Upper Tribunal has (apparently) resolved the uncertainty arising from contradictory FTT decisions on the proper treatment of conversion projects involving buildings containing a residential and a non-residential part. These extend back to *Calam Vale Ltd* (VTD 16,869), in which it was decided that a project that incorporated part of the previously residential part in each of two new dwellings did not qualify for zero-rating; if the upstairs had been residential and the downstairs not, then a conversion into ground floor and second floor flats would qualify for zero-rating on half, but a conversion into two semi-detached houses would not qualify at all.

This approach was not followed in the later case of *Alexandra Countryside Investments Ltd* (TC02751), where the judge noted the CA decision in relation to DIY claims in *HMRC v Jacobs* and concluded that there was no logical reason to allow a DIY claim under s.35 VATA 1994 but to disallow the zero-rating of an identical project under s.30 and Sch.8 Group 5. HMRC did not appeal that decision, but never agreed with it, and argued in later cases that it had been wrongly decided.

In late 2015, the *Macpherson* appeal (TC04756) related to the same kind of project – the conversion of a shop with living accommodation above into two semi-detached houses. HMRC ruled that the sales of both houses could only be exempt. The key point was the application of Group 5 Notes 7 and 9:

7: For the purposes of item 1(b), and for the purposes of these Notes so far as having effect for the purposes of item 1(b), a building or part of a building is "non-residential" if-

(a) it is neither designed, nor adapted, for use—

(i) as a dwelling or number of dwellings, or

(ii) for a relevant residential purpose; or

(b) it is designed, or adapted, for such use but—

(i) it was constructed more than 10 years before the grant of the major interest; and

(ii) no part of it has, in the period of 10 years immediately preceding the grant, been used as a dwelling or for a relevant residential purpose.

9: The conversion, other than to a building designed for a relevant residential purpose, of a non-residential part of a building which already contains a residential part is not included within items 1(b) or 3 unless the result of that conversion is to create an additional dwelling or dwellings.

The FTT "respectfully disagreed" with the Tribunal in *Alexandra Countryside Investments*. The FTT had to consider the conversion that had actually taken place: it was clear that the building that had been converted had not been, within the definition of the law in Note 7, "a non-residential building" before the conversion. In s.35, the law used the phrase "to the extent that", which allowed a project to qualify in part. Under s.30, it had to qualify or not qualify.

To put it another way, the judge in *Alexandra* appeared to have concluded that "Note 9 requires an additional dwelling to be constructed, which has happened, so the project falls within Item 1(b)"; the judge in the *Macpherson* case started from the opposite direction, holding that "Zero-rating requires the project to fall within Item 1(b) to begin with, which it doesn't because of Note 7, so it doesn't matter what the outcome of the project was." Similarly, Note 10 (which deals with apportionment) was not engaged. The project was wholly exempt, and the appeal was dismissed.

Then another FTT judge (Jane Bailey) disagreed again in *Languard New Homes Ltd* (TC04917). The project converted a three-storey pub into a four-storey building containing four dwellings. The two lower floors became maisonettes that incorporated part of the ground floor (formerly pub) and first floor (formerly manager's accommodation); two more "upper maisonettes" comprised the old top floor (formerly manager's accommodation) and the new top floor (new construction).

The appellant treated the sale of major interests in all four properties as zero-rated in 2011. It was subsequently agreed that the sale of the upper maisonettes was exempt, but the company appealed to the Tribunal in relation to the lower maisonettes.

The taxpayer's representative criticised the decision in *Macpherson* for a lack of any indication of when Note 9 would, or could, be engaged. He suggested that the reasoning of the Court of Appeal in *Jacobs* was compelling in relation to s.30, even if not binding as it would be in relation to s.35.

The judge posed the question as "*whether the ground floor was converted 'into a building designed as a dwelling or number of dwellings'*". She noted that the Tribunal in *Calam Vale* had decided this kind of project was not within Item 1(b), because it refers to "converting a non-residential building or a non-residential part of a building into a building designed as a dwelling or number of dwellings" rather than "converting a non-residential building or a non-residential part of a building into a building or part of a building designed as a dwelling or number of dwellings".

The judge commented that if this was correct, Note 9 could have no application. If item 1(b) could only apply to buildings that were wholly non-residential before the conversion, then there would always be a new dwelling or dwellings afterwards, because there would be no dwellings beforehand – so Note 9, which was drafted at the same time as item 1(b), would be meaningless. HMRC's representative was invited to suggest when it might apply, but could not come up with an example.

The judge also commented that a conversion would appear only to satisfy Note 9, under the reasoning in *Macpherson* if it not only was "horizontal rather than vertical" (creating two flats rather than two maisonettes) but also did not touch the formerly residential part at all – a project that affected the whole building would not be "a conversion of a non-residential part of a building", but would be "a conversion of a building containing a residential part". This seemed unnecessarily strict.

The comparison exercise was between the situation before (non-residential part of a building) and the situation afterwards (building containing four dwellings); the non-residential parts had changed their nature, and the supply of the major interest grants in the lower maisonettes fell within item 1(b).

That suggested that the whole supply was zero-rated, and the VAT incurred on work relating to the conversion of the first floor should also be recoverable – there was no scope for a claim "to the extent that", as there was in *Jacobs*.

Upper Tribunal

The taxpayer appealed in *Macpherson*, arguing that the FTT had it right in *Languard*; and HMRC appealed in *Languard*, arguing the opposite. The appeal came before Mrs Justice Rose and Judge Greg Sinfield. The judges noted that the FTT had used the social purpose of Group 5 as a tool for interpreting the statute, but considered that it had gone too far – it could not override the meaning of the law, properly construed.

The law was not particularly clear, but the judges preferred HMRC's interpretation. Note (9) was not devoid of content: "*It sometimes happens that a building comprising some commercial space on the ground floor and a large number of small flats on the floors above is converted into a building comprising a large flat on the ground floor and then a smaller number of larger flats on the upper floors; the small flats having been knocked together to create more spacious dwellings. In that situation Jacobs holds that even though the ground floor flat is within Item 1(b) because it is entirely made up of the former non-residential part of the building, it is excluded from zero-rating by the application of Note (9). One must count up all the dwellings in the converted part of the building (including dwellings made up of former residential space), not just the dwellings made up of the former non-residential part. But it is still the purely non-residential part that must be converted into a building designed as a dwelling.*"

The conclusion was that, in order for a conversion to fall within Item 1(b), the major interest granted in the dwelling must be of a building designed as a dwelling that had been converted entirely from formerly non-residential space and not from a mixture of residential and non-residential space. The problem did not arise in *Jacobs* because a DIY claim can be made "to the extent that" the project falls within Group 5; Mr Jacobs had only claimed VAT incurred on the conversion of the non-residential parts of the building. A zero-rated supply can only be one thing or the other, and not "to the extent".

The judges accepted that this appeared to breach fiscal neutrality, might influence developers to design conversions in particular ways, and could produce anomalous results in respect of apparently identical flats where part of the original building was residential. However, it appeared to be what the law said, and none of those considerations could override it.

The taxpayer's appeal in *Macpherson* was dismissed; HMRC's appeal in *Languard* was upheld.

Upper Tribunal: *HMRCv Languard New Homes Ltd; MacPherson v HMRC*

3.3.3 Sub-contractor supplies

An electrical contractor carried out works in relation to the construction of student accommodation. HMRC ruled that this was "relevant residential purpose" property, which can only be zero-rated at the point of supply to the end user; the company argued that it was also "designed as dwellings", so sub-contractors could zero-rated construction services all through the supply chain.

The design of the building was considered: it is a seven storey building comprising 140 studio flats and associated facilities. By reference to the plans it appears that each of floors 1 – 6 are substantially similar in layout with the majority of the studio flats being the same size approximately 5m by 3m and rectangular in shape. There are some larger studios on some of the floors and these are not all rectangular in shape. On the ground floor there is a communal reception, cycle store, and laundry. In addition management offices, stores, bins and plant rooms are situated on the ground floor. The planning consent required that at least 126 of the flats could only be occupied by students of one of two local universities.

The main contractor had provided the company with a zero-rating certificate, stating that the contractor's client intended to use the building for a relevant residential purpose. HMRC took this as an indication that zero-rating was not possible, because the appellant was a sub-contractor. The developer refused to pay the appellant the VAT on VAT-only invoices, arguing that the supplies had properly been zero-rated.

The questions before the FTT, therefore, were whether the studio flats qualified as "dwellings" within Note 2, and if so, whether the appellant had a choice between treating them as dwellings and treating them as RRP. In correspondence, HMRC had stated that the choice had to be exercised by the client, and this would then bind everyone else in the supply chain. As the client had issued a ZR certificate to the main contractor, in HMRC's view, the building could only be treated as RRP.

HMRC also argued (only a week before the hearing) that there was a prohibition on separate use or disposal, so the building did not qualify as "dwellings" within Note 2(c). The Tribunal referred to the Upper Tribunal decision in *Shields*, which clarified the distinction between a "mere occupancy restriction" (such as this one) and a restriction on separate use or disposal:

"*It is that required link to specific land or premises which is crucial, and which puts cases such as the present in a different category from those which have no such link or to which the link is too general or too tenuous. … No doubt there will be cases which are borderline and therefore difficult to call, but I do not regard the present case as one of those. Here the link between the occupancy of the building and the [fishery] is sufficiently close, specific clear and unequivocal.*"

The Tribunal in the present case was clear that this was a mere occupancy restriction – there was no link to particular land, but rather a restriction to a class of possible occupants.

On the issue of the choice between reliefs, the Tribunal emphatically rejected HMRC's arguments ("there is absolutely no basis for HMRC's policy or submission"), noting that they were initially made without reference to the legislation at all, and subsequently depended on a very particular interpretation of Note 12 of Group 5. The appellant protested that the policy set out in Notice 708 was inconsistent as, in relation to the legislation that applies where, within a period of 10 years, there is a change of use in relation to a relevant residential purpose building a change of use charge arises (in essence removing the benefit of zero rating) unless the building also qualifies as a dwelling or number of dwellings under note 2.

"*As HMRC stated the correct liability to tax is, in most instances, not discretionary. Any subcontractor can establish for itself whether the* *building that it is constructing meets the conditions of note 2. If the building meets those requirements the subcontractors supplies will be zero rated.*" A supplier whose building fell within both note 2 and note 4 would not care under which provision the supply was zero-rated, but if note 2 was satisfied, the more restrictive conditions of note 4 could be ignored. The appeal was allowed.

First-Tier Tribunal (TC06006): *Summit Electrical Installations Ltd*

3.3.4 Community Amateur Sports Club

A cricket club incurred costs in constructing a new pavilion. It appealed against a ruling by HMRC that the work could not qualify for zero-rating. The three issues for determination by the FTT were:

- whether the club, being a Community Amateur Sports Club, qualified as a "charity" for the purposes of Sch.8 Group 5 Note 6;
- if the club succeeded on that issue, whether the new pavilion was to be used by the club solely for purposes other than carrying on a business;
- alternatively, if the club succeeded on the charity argument, if the new pavilion was intended for use as a village hall or similarly in providing social and recreational facilities for a local community.

The Tribunal heard evidence about the history of the club, its constitution, and the circumstances leading to the construction of the new pavilion (the old one had been destroyed in a fire). A grant had been obtained from Sport England to help the project; the application emphasised the community benefit that would arise.

The Tribunal noted the various sources of funding obtained to finance the project. Unfortunately, once the contractor had concluded that VAT would have to be charged, there was not enough money to finish the job. Friends of the club lent money to enable the completed works to be paid for, but it is not clear whether there are still outstanding parts of the building project.

The FTT considered the definition of a "charity" for VAT purposes in some detail, noting that the club satisfied many of the features required by the law. HMRC argued that it could not be a charity, because the Charities Act 2011 explicitly excludes CASCs from its scope; they are treated in the same way as charities for most corporation tax purposes, but they are not charities, and are not required to be registered with the Charities Commission. However, the FTT considered that it was possible for a CASC to be a "Finance Act charity", as defined in FA 2010, because the Charities Act provision was a different definition made for a different purpose. In coming to this conclusion, it noted that it was "respectfully disagreeing" with the earlier Tribunal in *Witney Town Bowls Club*; but that Tribunal had not had the benefit of detailed submissions by counsel on the construction of the relevant provisions.

The club's purpose in promoting amateur sport was capable of being "for the public benefit" and therefore charitable within the meaning of the legislation. However, it was not the sole purpose of the club. It also existed to promote social activities, and this could not qualify as charitable.

That was enough to conclude the appeal against the taxpayer, but the FTT had heard argument on other issues, so it gave its conclusions. The club met the "registration condition" in FA 2010 Sch.6 para.3, because it was not required to be registered under the Charities Act. Although the legislation was strangely worded, it appeared only to require that the club had met any obligation it might have to be registered, and as it did not have one, it satisfied the condition.

The question of "relevant charitable purpose" was considered in the light of decisions from *Yarburgh Children's Trust* to *Longridge on the Thames*. Not surprisingly, following the recent Court of Appeal decision in *Longridge*, the FTT concluded that the receipt of income could only be "not economic activity" in exceptional circumstances, which did not apply here.

The consideration of whether the pavilion could be a "village hall or similar" was carried out in the light of precedents such as *Caithness Rugby Football Club*, *New Deer Community Association* and *Jubilee Hall Recreation Centre*. The test was the intention of use at the time the supplies were carried out, but the actual use of the pavilion was circumstantial evidence of that intention. The Tribunal was satisfied that the club would have succeeded on this issue.

The club also could not succeed with an argument based on fiscal neutrality. This would have had more force if the only UK law reason for denial of relief was a distinction between CASCs and "proper" charities; however, that was not the reason. Any charity acquiring a building for this mixture of activities would be denied relief, because it was not solely for charitable purposes.

The appeal was dismissed.

First-Tier Tribunal (TC06047): *Eynsham Cricket Club*

3.3.5 Extension or annex?

A builder carried out construction works for a charity and treated them as zero-rated. HMRC ruled that £5,956 of output tax was due. The issues were whether the project involved construction of an annex within Sch.8 Group 5 Note 17, and could therefore be zero-rated, or might alternatively be completion of the construction of the original building, in which case it was not an extension at all.

The original building had been constructed in response to a 2007 OFSTED report on the village school which noted the lack of anywhere for the children to have PE lessons. Funds were raised and the hall opened in May 2009, used for school in the daytime and as a village hall in the evening. There was a lack of storage space, which meant that changing over from one use to another was a laborious and inconvenient exercise.

Further funds were raised and an additional building was constructed for storage, becoming available for use in 2014. It was, physically, an extension to the existing building, with internal access and also with its own external double doors. In spite of this, the trustees argued that it met the conditions in Note 17:

(17) Note 16(c) above shall not apply where the whole or a part of an annexe is intended for use solely for a relevant charitable purpose and—

(a) the annexe is capable of functioning independently from the existing building; and

(b) the only access or where there is more than one means of access, the main access to:

(i) the annexe is not via the existing building; and

(ii) the existing building is not via the annexe.

They also argued that, in spite of the length of time between the original construction and the completion of the storage cupboard, it was all part of the construction of the single building, and should therefore be zero-rated as "new construction" rather than standard rated as an extension to an existing building.

The Tribunal judge (Geraint Jones QC) considered the difference, if any, between an "extension" and an "annex". He quoted from the judgment of Lightman J in *Cantrell & others v Customs & Excise* (1999):

"*I must add a few words regarding how the question is to be approached and answered, for this has been the subject of some lack of clarity (if not confusion) in a number of the authorities cited to me and it is the failure to approach and answer the question in this case in the correct way which flaw it. The question is to be asked as at the date of the supply. It is necessary to examine the pre-existing building or buildings and the building or buildings in the course of construction when the supply is made. What is in the course of construction at the date of supply is in any ordinary case (save for example in case of a dramatic change in the plans) the building subsequently constructed. Secondly, the answer must be given after an objective examination of the physical characters (sic, characteristics) of the building or buildings at the two points in time, having regard to similarities and differences in appearance, the layout, the uses for which they are physically capable of being put and the functions which they are physically capable of performing. The terms of planning permissions, the motives behind undertaking the works and the intended or subsequent actual use are irrelevant, save possibly to illuminate the potential for use inherent in the building or buildings.*"

Other precedents included *Cantrell (no.2)* (2003), *Leyton Sixth Form College* (TC03042) and *Abercych Village Association* (VTD 20,746). The judge applied the tests as follows:

- he considered that the building did not "look or feel" like an extension to the original building. It could not be used for any of the purposes that the main building was used for, having no windows and only artificial light. Storage was an ancillary or incidental function in the original building, but was the sole function of the new one. All of these factors placed it on the "annex" side of the line, rather than an extension.

- he considered that the requirement was that it was "capable of functioning independently", not that it actually functioned independently. The fact that it had external access meant that this was satisfied: it could be an independent storage facility.

- he regarded "main access" as something that did not depend merely on numerical use, but on the "status" of the entrance. "*Most householders would, for example, described their front door as the main access notwithstanding that, for pragmatic purposes they may choose to use the back or side door more frequently than the front door.*" He therefore decided that neither of the sets of doors was the "main access", of equal status, significance and importance to the differing users of the facilities.

That was enough to satisfy Note 17, and the appeal would be allowed. However, the judge went on to consider the arguments on the alternative ground of appeal. He considered that the only reason to disagree with the characterisation as "new construction" was the passage of time. This was largely explained by the difficulties in obtaining funding. Part of the original structure had been designed to accommodate the provision of extra storage when funding became available. The fact that planning permission was not in place "is a consideration but, in our judgement, not decisive". The function of the structure assisted or facilitated the original building. On the basis of a "fine value judgement" based on "rather unusual facts", the judge concluded that the construction should be regarded as the completion of the original building, and therefore zero-rated under both headings.

First-Tier Tribunal (TC06101): *Litton & Thorner's Community Hall*

3.3.6 Article

In an article in *Taxation*, Marie Stein considers important points about VAT on sales of land and buildings, with particular regard to sale of property for conversion. Issues covered include opted properties and disapplications, the various forms, and the possible Capital Goods Scheme implications.

Taxation, 6 July 2017

3.4 Input tax claims on land

3.4.1 DIY claim

An individual appealed against the rejection of a claim for £10,981 under the DIY scheme. The point at issue was a planning condition restricting occupation to a person working in the next door garage. This was so similar to other cases on this point that it was inevitable that HMRC were right. The appeal had been commenced in 2013, long before those other cases (in particular *Burton* and *Shields*) were determined in the Upper Tribunal, but the FTT in 2017 was bound to follow them.

First-Tier Tribunal (TC06040): *Duncan Lichfield*

3.5 Other land problems

Nothing to report.

4. INTERNATIONAL SUPPLIES

4.1 E-commerce

4.1.1 Exchange rates

HMRC have published the usual table of VAT MOSS exchange rates for the quarter ending 30 June 2017.

VAT Information Sheet 5/2017

4.2 Where is a supply of services?

4.2.1 Telecom changes

The Value Added Tax (Place of Supply of Services) (Telecommunication Services) Order 2017 takes effect from 1 November 2017. As announced previously, it removes the use and enjoyment provisions governing the place of supply of B2C telecommunications services. The change means UK VAT will be charged on all mobile phone services used outside the EU by UK consumers, "bringing the UK rules into line with the internationally-agreed approach".

The current 'use and enjoyment' provisions in relation to supplies of radio and television broadcasting services set out in paragraph 8 (now limited to broadcasting services) of Part 1 of Schedule 4A will remain unchanged.

A Tax Impact and Information Note has been published to help explain the changes.

SI 2017/778; TIIN: Removal of VAT 'use and enjoyment' rule for B2C mobile phone services outside EU

4.3 International supplies of goods

4.3.1 Vision for future customs arrangements

The government has set out its 'aspirations' for future customs arrangements in the first of a series of papers intended to share its thinking on the UK's relationship with the EU after Brexit. This sets out two broad approaches, both of which would involve effective continuation of the customs union for a 'time-limited interim period'. However, the negotiations are ongoing and agreement with the EU appears a long way off.

The two broad approaches involve:

- a 'highly streamlined' customs arrangement, continuing some existing arrangements between the UK and the EU, while implementing technology-based solutions including the new UK customs declaration service (CDS); and

- a new customs partnership with the EU, removing the need for a UK-EU customs border, possibly involving the UK mirroring the EU's requirements for imports from the rest of the world where their final destination is the EU.

In either case, the government proposes 'a model of close association with the EU customs union for a time-limited interim period'. No new arrangements would be brought into effect with third countries which were not consistent with the terms of this interim agreement. The paper does not offer any suggestions on the length of this interim period, which needs 'further consideration' as part of the negotiations.

www.gov.uk/government/publications/future-customs-arrangements-a-future-partnership-paper

Meanwhile, the European Commission has also published a position paper which establishes what it sees as essential principles to ensure an orderly withdrawal of the UK from the Union in respect of customs related matters. The principles set out what should happen with goods before withdrawal and after Brexit.

Commission Report, 8 September 2017

4.3.2 Online purchasing

HMRC have published research which looks at the attitudes and experiences of online shoppers, including misrepresentation or undervaluation, and consumer awareness of VAT and customs requirements. The research aims to help reduce the amount of undeclared revenue on non-EU internet sales, estimated to be £1bn – 1.5bn in 2015/16. The research claims to show that shopping online from non-EU sellers is a minority activity.

Around 63% of people in the UK said they had shopped online in the previous three months and both the qualitative and quantitative research found that price and convenience were the most important factors in choosing an online seller, followed by delivery time, brand recognition and good customer reviews.

Other findings include:

- shopping online from non-EU sellers is a minority activity, with only 16% of consumers who had shopped online in the past three months having knowingly purchased goods from sellers outside the EU.
- 10% reported that they did not know whether they had purchased an item from an overseas seller outside the EU, suggesting that buying from overseas could be more widespread than it seems.
- 43% of consumers who had shopped online in the past three months had not been aware whether they were shopping from overseas sellers at least some of the time.

Report: Prevalence of individuals shopping online from overseas and handling of VAT

4.3.3 Updated Notices

HMRC has published a raft of updated Notices in the area of international trade. Many of them have only been amended with new contact details for the National Import Reliefs Unit:

Notice 236: *Returned goods relief*

Notice 3001: *Customs special procedures for the Union Customs Code*

Notice 340: *Importing scientific instruments free of duty and VAT*

Notice 341: *Importing donated medical equipment free of duty and VAT*

Notice 342: *Importing miscellaneous documents and other related articles free of duty and VAT*

Notice 343: *Importing capital goods free of duty and VAT*

Notice 361: *Importing museum and gallery exhibits free of duty and VAT* (also includes changes to the legal reference from the European Commission to include latest regulations, updated to reflect current practices for "right to be heard" and reviews or tribunals)

Notice 364: *Importing decorations and awards free of duty and VAT* (also includes changes on "right to be heard" as above)

Notice 366: *Importing biological and chemical substances for research free of duty and VAT*

Notice 702/7: *Import VAT relief for goods supplied onward to another country in the EC*

Others have more varied amendments:

Notice 368: *Importing inherited goods free of duty and VAT* (updates in January 2007 and October 2007 now incorporated, also covering "right to be heard" and decision review process, and some other matters)

Notice 371: *Importing goods for disabled people free of duty and VAT* (updates in January 2007 and October 2007 now incorporated, also covering "right to be heard" and decision review process, and some other matters such as the definition of "disabled person", use of "nominated carers" and the treatment of non-specialised goods imported for subsequent adaptation)

Notice 372: *Importing commercial samples free of duty and VAT* (updates in December 2006 and October 2007 now incorporated)

Notice 373: *Importing visual and auditory materials free of duty and VAT* (various updates now incorporated, also covering "right to be heard" and decision review process, and some other matters)

Notice 374: *Importing goods for test free of duty and VAT* (update in April 2004 now incorporated, clarification in respect of the conditions for Excise Duty relief, deletion of a surplus paragraph 4.6)

4.4 *European rules*

4.4.1 EU public prosecutor

MEPs on the Civil Liberties Committee have given the go ahead to set up a European public prosecutor to fight fraud against EU funds. The European Public Prosecutor's Office (EPPO) will be in charge of investigating, prosecuting and bringing to justice those committing offences against the EU budget, such as fraud against the EU structural funds or large-scale cross-border VAT fraud.

www.europarl.europa.eu/news/en/press-room/20170928IPR84903/eu-public-prosecutor-to-fight-financial-fraud

4.4.2 Costs that benefit third parties

In the *Iberdrola* case, Advocate-General Kokott put forward an interesting summary of the issues in the relation to deduction of overhead expenditure. Her opinion would have been welcomed by HMRC, because it appeared to deny input tax unless a direct link could be found to a taxable output, rather than a benefit to the taxable business in general. However, the full court has declined to follow her line.

This was her statement of the principles under consideration:

1. How close or broad, from the point of view of VAT law, must be the link between the costs, on which VAT is charged, borne by an operator in order to generate revenue and his taxable transactions for deduction of input tax to be possible? Is it sufficient that the costs were beneficial or necessary for the undertaking? Is the mere cause of the costs by notified revenue enough or must the costs be directly and immediately allocated to the undertaking's revenue liable to VAT?

2. Is it sufficient, for example, if an undertaking arranges the renovation of the municipal waste-water infrastructure in order to obtain building permits for its buildings, which are to be leased on a taxable basis in future? Or do the renovation costs have to be allocated directly and immediately to particular transactions of the undertaking? In the latter case, deduction of input tax by the undertaking for the renovation costs depends on the assessment of the supply to the municipality, as the undertaking supplies the renovation directly and immediately to the municipality in its function as the authority responsible for waste-water disposal.

3. The Court is called on to consider these fundamental questions in these preliminary ruling proceedings. In answering them, regard must also be had to the Court's recent judgment in Sveda. That judgment has created some uncertainty in the Member States over the extent of the deduction of input tax. In the present case the Court now has an opportunity to clarify the statements made in that judgment.

In the case the company owned some land on which a holiday village was to be constructed. Income from letting the holiday accommodation would be taxable. However, the existing waste-water infrastructure, which belonged to the municipality, was inadequate to service the needs of the new buildings. Accordingly, the company entered into an agreement with the municipality whereby it paid for the upgrading of the infrastructure. It claimed input tax on the cost, and the tax authorities refused. The

Bulgarian Administrative Court held that the company had provided a service to the municipality free of charge; however, there was a link between the costs and the overall taxable activities of the company, and as a result the input tax was deductible. This decision was reached on the basis of "expert accounting evidence" to show the relationship between the costs of the infrastructure work and the taxable outputs. Questions were then referred to the CJEU.

The Bulgarian law contains a specific disallowance of VAT incurred on costs incurred in improving a property owned by someone else and enjoyed by both parties, if no charge is made. One of the questions asked whether this was permissible as a matter of law; the second asked whether, regardless of the Bulgarian law, it would be contrary to art.168 PVD to refuse deduction in these circumstances.

A-G's opinion

The A-G stressed that the manner of reflecting transactions in the entity's accounts could not be relevant for VAT. VAT taxes transactions, not "appreciations", so it ignores the accruals concept and never requires the presentation of a statement of assets and liabilities. How a cost is entered in the accounts will neither strengthen nor weaken a case for deduction.

The A-G went on to disagree with the company and the Commission in relation to the conditions for deduction. She said that both of them argued that "a merely causal link between inputs and economic outputs ... is sufficient for the deduction of input tax". She distinguished between an "economic allocation" and an "economic cause". Allocation was part of measuring profits, but it was not the test for VAT – art.168 refers to "use for the purposes of the taxed transactions", which is more positive than a simple allocation.

She pointed out that the whole scheme of input tax was part of the cumulative method of collecting VAT. Input tax was deductible because the cost was passed on to someone else who would account for output tax. If there was not such a specific relationship between inputs and taxed outputs, there was a risk that final consumption would not be taxed.

She drew a distinction between the costs in this case, and costs that were not related to anything particular, but were nevertheless connected with the economic activity as a whole. Such costs were costs components of the goods or services that the entity supplied, and the CJEU has held them to be deductible. However, if there is a direct link with a particular output, then using that output is the more precise method for determining the entitlement to deduct input tax. The more precise method takes precedence over a general consideration of total turnover.

It made no difference in the present case that the renovation of the infrastructure was a condition for the implementation of the construction project. The underlying purpose or motive was also irrelevant. The crucial factor was who – the taxable person or a third party – actually used the input and whether this would give rise to untaxed final consumption. In this case, only the municipality directly used the construction services for waste-water disposal, because only it maintained and operated the renovated infrastructure.

The situation was distinguished from *Sveda*, because in *Sveda* the company used the mythology trail for its own economic purposes. There was a direct and immediate link to its taxable outputs that was missing in the present case.

The A-G commented on the possible application of art.26 PVD to a supply of services “free of charge”. It was possible that this was a barter transaction: the supply of the infrastructure improvements in exchange for the advantage of being granted building permits. In that case, the input tax would be deductible, but output tax of the same amount would be due. Otherwise, there would be no output tax, and no input tax either. The “deemed supply” in art.26(1)(b) would not apply because the costs were not incurred for “purposes other than the purposes of the business”.

Full court judgment

It is curious that the judgment does not refer to the opinion at all, and does not refute the points that the Advocate-General makes. Instead, the court simply states that the right to deduct depends on the taxpayer using the inputs for the purposes of taxed transactions; the fact that someone else might benefit cannot be a reason to restrict the deduction. Accordingly, the company would have the right to deduct input VAT in respect of a supply of services consisting of the construction or improvement of a property owned by a third party when that third party enjoys the results of those services free of charge and when those services are used both by the taxable person and by the third party in the context of their economic activity, in so far as those services do not exceed that which is necessary to allow that taxable person to carry out the taxable output transactions and where their cost is included in the price of those transactions. If the expenditure went further than was necessary for Iberdrola to construct its holiday complex (which it would be for the referring court to determine), an apportionment would be necessary.

CJEU (Case C-132/16): *Direktor na Direktsia ‘Obzhalvane i danachno-osiguritelna praktika’ — Sofia v ‘Iberdrola Inmobiliaria Real Estate Investments’ EOOD*

4.4.3 Independent groups

The last update covered four cases in the CJEU concerning the exemption in art.132(1)(f) for “independent groups of persons”. One had received its full court decision, and the other three were the subject of inconsistent A-G opinions. The Aviva case has now been decided, and the court has agreed with A-G Kokott. The case concerned the “material scope” (whether it could cover insurance), “geographical scope” (application to cross-border transactions), and the stipulation that there should be no distortion of competition. She considered all the questions in some detail (her opinion is summarised below, from the July update, for reference); however, the court concluded that it did not need to answer any of the questions, because of the answer it gave to one that was implied but not expressly asked.

The Aviva group provides insurance products throughout the EU. It wanted to establish an EEIG (European Economic Interest Grouping), which is a direct tax related structure for sharing services. The EEIG regulations prohibit it from making any profit, so presumably it must only recharge exact shares of underlying cost. It was noted that the EEIG would provide services to group companies in 12 different member states;

those group companies would provide mainly exempt services in the insurance sector, but might have some incidental taxable activities as well.

Aviva wanted a ruling that the cost-sharing exemption would apply. The Polish authorities took the view that the “non-distortion of competition” condition would be violated. The following questions were referred to the CJEU:

(1) Is a provision of national law concerning the exemption from VAT of an [IGP] which does not lay down any criteria or procedures governing the fulfilment of the condition on distortion of competition compatible with PVD art.132(1)(f) in conjunction with PVD art.131, and also with the principles of effectiveness, of legal certainty and of the protection of legitimate expectations?

(2) What criteria should be applied in assessing whether the condition on distortion of competition laid down in PVD art.132(1)(f) is fulfilled?

(3) Is the answer to the second question above affected by the fact that the [IGP] provides the services to members which fall within the jurisdiction of different Member States?

The A-G considered that the purpose of the exemption was to reduce the competitive disadvantages that taxable persons sharing resources would otherwise suffer. This was not, contrary to the submission by the Commission, a departure from the principle of fiscal neutrality. Insurance and banking services were exempted under art.135 for reasons different from those applicable to the activities exempted under art.132 (respectively, the imposition of insurance taxes and the difficulty of determining a taxable amount). Both the purpose, and the positioning of art.132(1)(f) within the “public interest exemptions” rather than as a provision applicable to exemptions in general, suggested to the A-G that it should only apply to art.132 exempt bodies. If the principle should be extended to art.135 exemptions, that would be a matter for the legislature.

The principle of fiscal neutrality did not require the exemption to be available. Neutrality required deduction of input tax if inputs were used for taxable transactions, and equal treatment of similar businesses. Neither of these suggested that exemption should be applied to transactions within a group of insurance companies.

In case the full court took a different view of the basic applicability of the provision, the A-G went on to consider whether art.132(1)(f) should apply to cross-border transactions. She noted that some provisions (e.g. art.11) explicitly ruled out cross-border application, and others (e.g. art.148(e)) explicitly referred to it. Art.132(1)(f) made no mention either way. She therefore took no inference from the wording of the law.

Rather, she considered in some detail:

- the history of the exemption scheme;
- the scheme of the exemptions;
- the evaluation of art.11(1) PVD (which requires VAT groups all to be established in a single Member State);
- the competition clause in art.132(1)(f); and

- the possibility of exploitation of different regimes in different countries.

In relation to the first two points, the A-G noted that art.13 6th Directive was headed “exemptions within the territory of the Member State”, and cross-border exemptions are dealt with separately in a later chapter of the PVD.

As art.11(1) only allows grouping (disregard of transactions) between companies established in the same Member State, it would be inconsistent to allow art.132(1)(f) (exemption) apply across border.

The CJEU’s approach to distortion of competition required a Member State to consider an activity in itself, without regard to the circumstances of a particular local market. The context of this statement in the *Isle of Wight Council* case suggested that the Member State should consider the operation of the VAT rules in the Member State as a whole. It would be practically impossible for the Member State to consider the circumstances of other countries as well.

The A-G considered that a strict interpretation of the exemption rule would not contravene the fundamental freedoms in the EU Treaty. It would also prevent the possibility of exploitation by international groups that might otherwise organise central buying of services in a non-VAT country such as the USA, followed by an exempt supply to the EU group, avoiding the reverse charge that would be charged on a direct purchase by the EU company.

If the full court considered that the exemption was in principle available, the A-G suggested the following as a way of assessing whether it would create a risk of a distortion of competition:

An indication that the exemption provided for in Art.132(1)(f) PVD is being applied inappropriately may be that the group supplies the same services for consideration to non-members and is to that extent, by exploiting effects of synergy, operating on the market. This may constitute a correspondingly genuine risk of distortion of competition. Another indication may be that the primary purpose of the group’s formation is simply to optimise the input VAT burden (that is to say, to create a competitive advantage by switching any necessary peripheral services to a group) rather than to establish reciprocal cooperation with a view to avoiding a competitive disadvantage. Yet another indication may be that the group does not supply any services tailored to the specific needs of its members, with the result that its services could just as easily be offered by others too.

After a long and detailed consideration, the A-G’s recommendation to the CJEU for its answers to the questions was very brief. She said that it was necessary to apply a restrictive interpretation of “distortion of competition”, even if it was not in the Polish law. The exemption also only applied to supplies by a group to those of its members who are subject to the same legal system as itself, i.e. established in the same Member State.

The full court noted that exemptions have to be considered not only on their written terms (which, in this case, do not exclude the possibility of the exemption applying to insurance companies) but also to their context. The exemption for IGPs appears in art.132, which is in Chapter 2 of Title

IX dealing with exemptions. That distinguished it from Chapter 1 ("General Provisions") and Chapter 3 ("Other exemptions"), and indicated that it was only available to bodies which were carrying out activities in the public interest, in accordance with the heading of Chapter 2. That conclusion was further strengthened by the need to interpret exemptions strictly.

Because the exemption should not be available at all, it was not necessary to answer any of the questions referred, because they presupposed that it was available. The court noted that a number of member states have implemented IGP rules that do not distinguish between types of exemption, following the inconclusive judgment of the CJEU in *Taksatorringen* (Case C-8/01). The court emphasised that the principles of legal certainty and non-retroactivity would prohibit member states from reopening settled years to implement the present decision; they would also prevent a member state from changing its own law with retrospective effect, because the state could not rely on the EU law (as interpreted by the CJEU) to override its own faulty legislation.

Presumably those member states that have implemented the provision in this way will now have to change their own law. The UK is one of those states, but it may be a low priority to change the law, unless consistency with the detail of the Single Market rules becomes an important issue in the Brexit negotiations.

CJEU (Case C-605/15): *Minister Finansów v Aviva Towarzystwo Ubezpieczeń na Życie S.A. w Warszawie*

The last update also reported the A-G's opinion in *Commission v Germany*, where the Commission objected to the German law on IGPs because it restricted it to bodies involved in the healthcare sector. The Commission argued that the scope of the exemption for IGPs should not be restricted at all; however, the court followed the same course as in the *Aviva* case above to rule that it should be restricted to bodies exempt under art.132, not art.135. Even so, the Commission's case was well-founded, because there could be no restriction between art.132 bodies.

The court rejected Germany's argument that this was a permissible application of the restriction on the exemption where there is a risk of distortion of competition. The German law required competition and distortion to be considered in relation to health sector IGPs, and Germany had not explained why other sectors should not be subject to the same rules.

CJEU (Case C-616/15): *Commission v Germany*

The other case on IGPs, *DNB Banka AS v Valsts ienemumu dienests*, was dealt with very briefly by the court. It concerned the possible application of the exemption to cross-border charges in a financial group of companies. The Latvian court had referred six questions about the way in which the IGP exemption might apply; but, because art.132(1)(f) could not apply to a financial institution, it was not necessary to answer any of them.

CJEU (Case C-326/15): *DNB Banka AS v Valsts ienemumu dienests*

4.4.4 Interest on delayed repayment

A company claimed a repayment of approximately €12.4m from the Hungarian tax authorities in September 2011. The authorities carried out an investigation, and eventually paid the claim in part, but only after fining the company three times for failure to provide information in response to requests. The company claimed interest from 4 December 2011, when it said the claim should have been paid, until 13 November 2013, when it was paid. The tax authorities said that the failure to cooperate with the investigation meant that no default interest was due. That was the effect of the Hungarian law, so questions were referred to the CJEU to determine whether that was permitted under EU law.

The court ruled that the principles of fiscal neutrality required that the taxable person should not bear the burden of the VAT on its costs. This meant that the state could not impose conditions that prevented recovery of such VAT; repayment should be made within a reasonable time, and if that was not done, interest should be paid to compensate for the financial losses resulting. The Hungarian law was not compatible with the EU law, because it had the effect of denying interest for the period of delay in these circumstances.

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

4.4.5 Subcontracted transport

A company (A) contracted to transport goods placed under a transport procedure from Latvia to Belarus. Another company (L) was subcontracted to perform the contract, using vehicles owned by A and leased to L. L was responsible for driving the vehicle, repairs, refuelling, customs formalities at border points, surveillance of the goods, transferring the goods to the consignee and the necessary loading and unloading tasks. It applied a 0% rate to the supply, considering that it was exempt with credit under art.146(1)(e) PVD as “services connected with international transport”.

The Latvian authorities ruled that L was not entitled to the zero rate. It had no legal relationship with the consignor or the consignee of the transported goods, so it was not a transporter or freight forwarding agent; and it did not hold the appropriate licences in Latvia to be treated as a carrier.

The court agreed with the authorities: art.146 required a “direct connection” with the importation or exportation, and the chain of supply in this case meant that there was only an indirect connection. Exemption did not apply to such a supply.

CJEU (Case C-288/16): *‘L.C.’ IK v Valsts ienemumu dienests*

4.5 Foreign refund reclaims

Nothing to report.

5. INPUTS

5.1 Economic activity

Nothing to report.

5.2 Who receives the supply?

5.2.1 Transfer of business?

A partnership (HHL) owned a substantial house with converted stables. It registered for VAT in August 2004 and made standard rated supplies of holiday accommodation in the former stables, while the partners lived in the main house. In 2010, the partners decided to provide holiday accommodation in the main house as well, and reclaimed input tax on substantial alteration and refurbishment works. In March 2013, the partners were advised to set up a new partnership (LMP) to undertake this letting. HHL raised an invoice to LMP in respect of the works undertaken up to that point, £433,521 plus VAT. LMP claimed the VAT as input tax. The invoice was settled by reducing the partners' loan accounts with HHL.

In July 2013, HHL was declared to be insolvent, and the output tax on the invoice was never paid to HMRC. HMRC raised an enquiry into LMP's first return, and found a number of issues as well as the main transaction: there were two invoices on which HHL had already claimed credit, one on which the supplier had not charged VAT, and some others that were dated before 1 April 2013 and were therefore proper to HHL rather than LMP.

HMRC ruled that the input tax on these and the main transaction was not deductible. They argued that there had been no supply from HHL to LMP: HHL had consumed the supplies in its own business, and could not sell them on to someone else. It had also not declared the invoice or the output tax in its insolvency.

The FTT allowed an input tax claim in relation to the transfer of fixtures, fittings and equipment (£6,660). However, it agreed with HMRC that VAT of £86,704 on the "transfer of construction works" was not deductible. The penalties, which had been assessed at £46,238, were variously cancelled and reduced to a total of £2,834.

The traders appealed to the UT on the denial of the £86,704. The key point was derived from Case C-283/12 *Serebryannay*: the FTT had concluded that LMP had to have been in existence when HHL had incurred the building costs in order for LMP to be able to deduct the input tax. The taxpayer also argued that the FTT had found incorrect facts: that LMP had not existed at an earlier date, and that the supply had to be considered to be project management services.

The UT agreed with the FTT that *Serebryannay* confirmed a principle that reciprocity of obligation had to exist at the time the supply was made. What the FTT had referred to as a "temporal disconnect" was the impossibility that HHL could, in June 2013, retrospectively create that reciprocity of obligation with LMP, when the supplies to which it related had taken place much earlier. There was no understanding, as there had been in the CJEU case, that a different barter supply would take place – at the time HHL had undertaken the work, it had intended to use the inputs for the purposes of its own business.

The partnership's appeal was dismissed.

Upper Tribunal: *Kelly and another (trading as Ludbrook Manor Partnership) v HMRC*

5.2.2 Tax avoidance promoter

A partnership promoted tax avoidance schemes. It incurred and claimed input tax on barristers' fees, where the only possible output consideration was a contingent success fee. The facts were a little complicated by the existence of separate businesses:

- NT Advisors 2009 LLP, which was said to owe over £1m in VAT, in spite of having few outputs on recent returns;
- NT Advisors LLP, which had swapped names with the above LLP on 27 April 2009;
- NT Advisors Partnership, which was formed under the Partnership Act 1890, and was a partnership of two trusts of which the same individual (Matthew Jenner) was the sole trustee. It purchased a business from 2009 LLP on 6 March 2015. This partnership was registered for VAT from 19 April 2015, ticking "TOGC" on the online application but declining to take on the VAT number of the predecessor 2009 LLP. The 2015 agreement defined what was transferred to the new partnership and what was retained by the seller.

The input tax claimed on the partnership's first VAT return was first enquired into, then refused, by HMRC. The grounds were that the barristers' invoices were made out in the name of 2009 LLP. The trader responded that the barristers had not updated their records, and the business purchase agreement created a bare trust relationship: the supply was made to the partnership, not to 2009 LLP.

The review of this decision took a great deal of time, during which HMRC apologised for failure in allocating a caseworker, and also stated that new information should initially be sent to the officer who made the decision. Eventually the decision was confirmed on review.

The appellant submitted that the barristers' supplies were made to the partnership when the invoices were raised, even if the services might have been made before the transfer of the business. The effect of the TOGC was to regard the successor as the same as the predecessor business, so the input tax should be allowed on the same basis. This should not be affected by taking over or declining to take over the predecessor's VAT number.

HMRC responded that the supplies had been made to the other business. The purchase agreement did not assign any significant right to receive future consideration in respect of the supplies that had been made by the LLP in the past, so there were no outputs to which the inputs were referable. The bare right to deduct input tax could not be assigned by one business to another, and the partnership did not carry on any economic activity.

HMRC also claimed the right to set off any amount that the Tribunal did think was due to the appellant: they would deduct it from the amount owed by the LLP. The Tribunal agreed with the taxpayer's representative that this would not be a matter appealable before the Tribunal if it came to be relevant at some future point.

The judge noted that HMRC had raised at the hearing that the transfer of the business was not a "normal commercial transaction", and accepted the taxpayer's representative's objection that this was an allegation of "sham" that had not been pleaded. He therefore disregarded the suggestion.

He went on to consider whether the LLP would have had the right to deduct input tax on the barristers' fees, even if there was no prospect of earning future income. He described the business model as "unusual but not unprecedented": it received fixed fees upfront, which were taxable; incurred significant costs in the short term, in implementing the tax avoidance scheme; incurred further smaller costs, over perhaps a number of years, in defending the schemes; and might eventually receive further taxable income in the form of success fees, but might never do so. In the judge's view, the obligation to incur the "tail" of legal fees over a number of years existed at the time the initial fee income was received, and the costs were therefore cost components of the taxable supply. The LLP would therefore have been entitled to a deduction.

The business purchase agreement transferred both customer contracts (with the relatively remote possibility of future success fees) and supplier contracts (with the barristers) to the partnership. Although HMRC objected that the right to deduct was not transferred if the traders did not transfer the registration number, the judge ruled that this was not a requirement. There was link to the possible future supplies the appellant made, and also to the actual supplies its predecessor had made.

The judge concluded by noting that HMRC might understandably wish to apply a "hyper-literal" interpretation of the statutes when dealing with the liabilities of a taxpayer who promoted such interpretations to make money out of HMRC. However, there was no legal reason to do so, and the appeal was allowed.

The judge includes as an appendix some comments about a letter from the officer who made the decision about input tax, in which she said that the taxpayer had incurred a late notification penalty, but HMRC would not charge one. The judge analysed the legal basis of the contents of the letter and showed that it was based on very muddled thinking: there did not appear to have been an obligation to notify; if there had, HMRC would have been obliged to issue a penalty, although they might then accept a reasonable excuse or a claim for mitigation; HMRC refer to a "special reduction" under FA 2008 Sch.41 para.14, which could not apply, and warn that a "repeated failure" would lead to the reduction being withdrawn – even though it would be extremely unlikely that the business would receive another TOGC and fail to notify liability to register, particularly given that it had now registered, but even if that happened, it would still be possible for special circumstances to apply.

First-Tier Tribunal (TC06061): *The NT Advisors Partnership*

5.3 Partial exemption

5.3.1 Toolkit

HMRC have as usual updated the toolkits that are intended for agents to use when assessing the reliability of a client's systems for producing accurate VAT returns. They are a good guide to the risks of error that may arise, but the practicality of using them as an external VAT adviser is questionable. They are likely to be very useful for internal auditors.

HMRC Toolkit: *VAT Partial Exemption (2017)*

5.3.2 Apportionment

A charitable guarantee company appealed against assessments for £37,621 covering periods 10/14 to 03/15 and £37,501 covering periods 04/15 to 03/16. The charity's activities related to the conservation of woodlands and the improvement of the environment for public enjoyment and appreciation.

The company registered for VAT in 1994. It operated its woodlands as a potentially taxable business, but there would be no income for many years. In the meantime, it had some exempt letting income. In 2000 it agreed with HMRC that an income based method would be inappropriate for recovery of its overhead input tax, because its activities were directed towards the long-term taxable income from the woodlands, rather than the current exempt rental of farmland. A method was agreed in January 2001 to regard 93.59% of residual VAT as input tax, and 99.02% of that was creditable.

In 2013, an assurance visit noted that two more estates had been added; the method in use produced 95.81% business use and 87.06% taxable use. Following this visit, the officer expressed concerns that the splits were not fair and reasonable, and began a correspondence. He suggested that the taxable sale of timber in 100 years was not a primary purpose of the company, but a consequence arising from its charitable non-business activities.

In particular, he disagreed with the use of a land-based apportionment between business and non-business use. The company's woodlands were regarded as wholly business. The officer suggested a different method based on sources of income, which included non-business investments and grants. He included as "business" income from farming of £5,880, rents receivable £51,415 and sundry receipts of £12,028 which he seemed to attribute to sales of timber. As non-business income he included income from investments of £410,251, deposit interest of £1,939 and woodland grants of £295,309. The charity's accountants responded that the officer was missing the point, and could not see why the existing method was regarded as not fair and reasonable. On being cross-examined at the hearing, the officer said that he did not regard it as reasonable "because it allowed too much input tax credit".

The Tribunal took evidence from the company's manager and forester. It found that the operations were similar to those of a commercial operator and were in the initial development phase. There was no activity carried on in the woodland areas that was not part of the woodland operation; all the conservation benefits and aims were achieved only as a by-product of the forestry operations.

The Tribunal also took evidence from the company's bookkeeper on how the VAT return was prepared, including the coding of different expenditure between the various activities. HMRC considered that many of those that were attributed wholly to taxable activities should in fact be "pot" and apportioned. These included the costs of planting, improving and maintaining the woodlands. In HMRC's view, these costs were used mainly to fulfil the charitable, non-business purpose of the company.

The Tribunal agreed with the taxpayer that HMRC were missing the point of cases such as *Longridge on the Thames*. The purpose of a charity's activities was not relevant; the VAT treatment was based on what it objectively did, not why it did it. *Larentia + Minerva* confirmed that apportionment to non-business activities required there to be discrete and identifiable separate non-business activities; here, there was none. Everything done in the woodland areas related to the business.

HMRC's representative argued that the link between trees bought in 2015 and felled for sale in 100 years might be "direct", but it was not "immediate". The Tribunal did not agree that there was a temporal meaning to this expression. The link was similar to that in *Sveda*, and the charity was acting at all times as an economic operator.

It would still then be necessary to consider the fair and reasonable apportionment of "pot" costs. The Tribunal held that HMRC's use of current income completely failed to recognise the particular economics of woodland management, and could not possibly be fair and reasonable. It was still necessary to consider whether the appellant's method met that standard. HMRC's main objection was to the inclusion of "mixed use land" as "wholly business", but the Tribunal had decided that there was no non-business use of the woodland. The objection therefore fell away.

The appeals were allowed.

First-Tier Tribunal (TC06021): *Will Woodlands*

5.3.3 Attribution

A well-known tennis club made exempt supplies of sporting services to its members, and taxable supplies of food and drink in its bars and restaurants. It incurred costs refurbishing bar, restaurant and café facilities on its premises. HMRC took the view that this was "pot", recoverable according to the partial exemption method in force; the club appealed, arguing that it ought to be wholly attributable to taxable supplies.

Judge Jonathan Richards considered the way the club was run and its various sources of revenue. The majority of income was derived from subscriptions; the bar and restaurant income was not essential to the viability of the club.

He noted the following clause from the club's rules:

[The Club] will provide the Members with facilities for lawn tennis, real tennis, rackets, squash rackets, table tennis, a gymnasium, bridge, snooker and billiards and such other facilities as the Board may decide are in keeping with the aforementioned activities in a sociable

environment with other advantages and facilities at the Club Premises from time to time.

He accepted the submission of Robert Maas, who appeared for the club, that this did not impose any obligation on the club to provide bar and restaurant facilities to the members. He rejected a submission by HMRC's representative that, having taken the decision to provide such facilities, the club had a contractual obligation to maintain them. The club's conduct was consistent with it having a discretion, but not an obligation, to continue to provide cafe services to the members.

It is interesting to note the facts found by the judge before discussing the legal consequences:

(1) Mr Dhanoa's [the finance director] unchallenged evidence, which I have accepted, was that most members use the Club to play sport only, without using other facilities that the Club provides.

(2) In 2011-12 the Club had a six-year waiting list for membership. As at the date of the hearing, that had increased to a ten-year waiting list.

(3) The Club did not reduce membership fees to reflect the inconvenience that members suffered while the refurbishment of the bars and the Grille restaurant was ongoing. On the contrary, membership fees rose in line with inflation during this time.

(4) The Club has a "clubhouse" that consists of four buildings. The Grille restaurant and the refurbished bars occupy just part of the first floor of one of those buildings and does not, therefore, comprise a large proportion of the communal and social space available to members.

(5) I have accepted Mr Dhanoa's unchallenged evidence that the Club does not seek to attract non-playing members and that applicants are not permitted to join the Club as a social member. The Club does have a "social membership" category. However, all social members are former playing members who are not able to participate in sport (for example because of their age, because they are pregnant or because they are injured). Restrictions are placed on the ability of social members to use sporting facilities and each switch from the playing membership category to the social membership category must be individually approved by the Club's chief executive.

The precedents considered included *BLP, Midland Bank, Dial-A-Phone Ltd* and *Southern Primary Housing Association Ltd*. These required inputs to have a direct and immediate link to particular outputs in order to be attributable to them; there had to be a "sufficient" link, and the attribution would not simply follow the "closest" link. A "but for" link was not enough. The judge was also referred to several Tribunal decisions, some of them covering refurbishment of buildings by sports clubs; he commented that these were not binding precedents, but helped to illuminate the way in which other Tribunals had approached the application of the principles to a very fact-specific situation.

HMRC argued that there was a link between the refurbishments and two exempt supplies, sufficient to make the costs "overhead":

(1) supplies of membership that the Club made to its members; and

(2) hire of the bars and restaurant to members.

The judge did not agree that the second of these was exempt – it would be incidental to a supply of catering, and therefore excluded from exemption under Sch.9 Group 1, even if the Club had not opted to tax the buildings.

The judge went on to acknowledge that members who use the Grille restaurant and bars regard it as a desirable feature of membership of the Club. However, that did not establish a direct and immediate link with the provision of exempt supplies consisting of membership of the Club. Rather, the relevant question was whether there was a direct and immediate link between the renovation goods and services that the Club received and the decision of members either to become members, or to renew their membership.

No adjustment was made to the fees when the refurbishments were in progress; that there was no contractual assurance that exclusive access to the restaurants would be maintained; that the waiting list and fees increased even while the refurbishments were in progress. All these facts suggested that there was no direct and immediate link between the renovation goods and services and exempt supplies that the Club made to members who either renewed their membership or chose to become members for the first time.

The decisions of the FTT in *Bridgnorth Golf Club* (TC00094) and *Bedale Golf Club* (TC04619), in which golf club catering facilities were held to have a sufficient link to exempt membership subscriptions, were based on very different facts. A large club offering world-class sporting facilities, with no contractual obligation to provide restaurant facilities to its members, most of whom did not use them, was very different from a small golf club with modest facilities and a single clubhouse.

The overall decision was that there was no direct and immediate link between the costs and the club's exempt supplies. The result was that the input tax on the costs was recoverable in full.

First-Tier Tribunal (TC06119): *The Queen's Club Ltd*

5.4 Cars

Nothing to report.

5.5 Business entertainment

Nothing to report.

5.6 Non-business use of supplies

Nothing to report.

5.7 Bad debt relief

5.7.1 Out of time

A company claimed bad debt relief in August 2015 in relation to invoices issued in 2007 and 2008. HMRC refused on the basis that the claims were made out of time. As a preliminary issue, the Tribunal established that the debts were written off in the company's accounts in its year ended 31 March 2012. The amount involved was £27,090, relating to gross debts of £181,892.

The invoices had been issued when the company was the representative member of a group of which one member subsequently went into liquidation. The owner of the surviving company said that the delay in making the claim arose from illness and from extended litigation with the liquidators of the group company. There were more bad debts, but the details could not be proved for the others.

The Tribunal judge makes some interesting comments about the difference between a "general provision for bad debts" and a "specific provision", which she seems to regard as "when the debts are written off". In her view, a "specific provision" was made in 2012, but not in 2013. Her explanation of the figures from the accounts is hard to follow, and was probably not helped by the fact that the company's accountant had died and was not available to give more explanations. However, she was satisfied that there had been no write-off of the debts that would satisfy s.36 VATA 1994, and therefore no valid claim to relief.

The appeal was dismissed.

First-Tier Tribunal (TC05990): *Gladstone F1 Ltd*

5.8 Other input tax problems

5.8.1 Toolkits

HMRC have as usual updated the toolkits that are intended for agents to use when assessing the reliability of a client's systems for producing accurate VAT returns. They are a good guide to the risks of error that may arise, but the practicality of using them as an external VAT adviser is questionable. They are likely to be very useful for internal auditors.

HMRC Toolkit: *VAT Input Tax (2017)*

5.8.2 Evidence

A company had claimed input tax of £20,679 for periods 08/11 to 02/13; HMRC ruled that it did not have sufficient evidence to support those claims. The company was not represented at the hearing, which proceeded anyway on the basis of HMRC's counsel presenting the appellant's case.

The business had registered in February 2011. An enquiry was opened in 2013 after input tax claims had been received and no outputs declared. The business was supposed to be a PR consultancy that would put UK companies in touch with companies in Nigeria. The owner of the business could not produce any evidence of ongoing engagements. He said the company also carried on a minicab business, but there were no explanations of how the businesses could sustain losses of £150,000 on turnover of less than £20,000 in the period under review.

The Tribunal considered the history of the dispute between the parties, which had gone to ADR (unsuccessful because the trader had produced no new evidence); it concluded that the trader had failed to maintain adequate records, so the assessment under s.73(2) VATA 1994 was validly raised. The decision was confirmed and the appeal dismissed.

First-Tier Tribunal (TC05972): *Pat Willis Eco Ltd*

A company registered for VAT in 2009, stating that its business was the purchase and sale of mobile phones. At registration, it did not expect to make regular repayment claims, but all its returns were of that nature. In due course, HMRC investigated the returns for 10/10 and 07/11, and made amendments to deny most of the input tax claimed (about £75,000 and £2,000). The company appealed, but was not represented at the hearing.

HMRC's representative stated that the decisions were not based on *Kittel* – it was not alleged that the trader knew or ought to have known of a connection to fraud. Rather, the invoices supporting the input tax claims were invalid. Some were not genuine receipts; some related to purchases made by other people not acting as agents of the company; some were duplicated; some were zero-rated; for some claims there was no evidence at all, or no apparent connection to the business.

The Tribunal considered written submissions from the trader, which alleged unfair treatment. However, after considering each category in detail, and the absence of any meaningful response from the company to reasonable requests for evidence or explanation, the judge dismissed the appeals in full.

First-Tier Tribunal (TC05977): *IQRA Associates UK Ltd*

5.8.3 MTIC

A company appealed against a refusal of input tax of £99,783 for periods from 12/14 to 06/15 on *Kittel* grounds. HMRC applied for the appeal to be struck out on the grounds that the company had been dissolved on 1 March 2016: the Tribunal did not have jurisdiction to hear an appeal from a non-existent appellant.

The company and the proprietor did not attend, although they had been notified. The judge decided that it was in the interests of justice to proceed. He reviewed HMRC's account of the company's trading, which featured "back to back" deals paid for in Bitcoin. The account of the company's activities reads as a straightforwardly artificial attempt to generate VAT repayments.

The judge agreed with HMRC on all points. He dismissed the appeal for lack of jurisdiction, but also set out his conclusions on the evidence in case the proprietor was considering applying to have the company restored to the register. He agreed with HMRC's refusal of input tax, the raising of a £60,415 assessment to output tax, and a penalty of £38,837 levied on the director personally (which decision had not been appealed by the director).

First-Tier Tribunal (TC06044): *Navee Ltd*

5.8.4 Non-payment

A company appealed against an assessment disallowing input tax of £11,770 in relation to purchases of flooring products. HMRC considered that the purchases had not been paid for within the six month period specified in VATA 1994 s.26A, so the input tax claim should have been reversed. A 10% penalty was added.

Following a partially successful ADR, the company accepted that some of the purchases had not been paid for, and accepted liability for £6,574 of the VAT. The remainder was still in dispute. The company was not represented at the Tribunal, which had refused an adjournment.

The grounds of appeal were that the disputed amounts had been paid from cash withdrawals from the business. HMRC had examined the bank statements and could see payment of some of the invoices, which they accepted, but did not agree that the cash withdrawals could be assumed to represent payment of the invoices.

The judge appears to have tried very hard to be fair in the absence of the appellant, but could find no reason to fault any part of HMRC's actions, or to accept any part of the taxpayer's arguments. The appeal was dismissed.

First-Tier Tribunal (TC05991): *Capital SMA Ltd*

5.8.5 Museums etc.

The Value Added Tax (Refund of Tax to Museums and Galleries) (Amendment) Order 2017 adds 31 additional bodies and their respective specified museums to the list of bodies that are entitled to claim a refund of the VAT incurred by them that is attributable to the provision of free admission to specified museums and galleries which they operate. It takes effect on 1 November 2017.

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6. ADMINISTRATION AND PENALTIES

6.1 Group registration

Nothing to report.

6.2 Other registration rules

Nothing to report.

6.3 Payments and returns

Nothing to report.

6.4 Repayment claims

6.4.1 Price reductions

Four companies (ITS, PAB, STS and Bell) sold tax avoidance schemes, mainly involving SDLT, and mainly to individuals. The relevant contractual arrangements between the Appellants and their customers took various forms but all included an undertaking, subject to conditions, to refund the fee charged for the SDLT avoidance scheme if it proved to be unsuccessful. All the schemes did indeed prove to be unsuccessful. The obligation to repay all the fee income led to the administration or liquidation of the companies.

The appellants issued credit notes to their customers as evidence that the fees were repayable. However, no payments were made as the companies were insolvent. Repayment claims were made based on reg.38 SI 1995/2518; HMRC paid some of these, and then sought to claw the money back again: they assessed ITS for £577,892, PAB for £1,573,862, STS for £776,877 and Bell for £180,710. HMRC also refused two claims by ITS for repayments of £1,511,823 and £614,371. HMRC argued that no repayment was due for two reasons:

- First, a price reduction or decrease in consideration requires and is limited to the amount of the consideration for the supply actually repaid to the customer (‘the price reduction issue’).
- Secondly, some of the customers did not have a contractual right to a refund and, as the joint administrators/liquidators could not make ex-gratia payments out of the assets of the Appellants, no question of a price reduction or decrease in consideration arose in those cases (‘the contractual liability issue’).

The taxpayers’ counsel argued that art.90 PVD referred to a “price reduction”, not a repayment. Art.73 set the taxable amount on liability to pay consideration, not on consideration actually paid. HMRC responded that consideration is “the amount obtained or to be obtained”: the companies had actually received the original payments and were not going to repay them, so that was the taxable consideration. In *Freemans v Customs & Excise* (Case C-86/99), which was about sales commission credited to selling agents, the CJEU held that it was not enough to trigger art.90 that a person is entitled to receive a discount at the time of purchase – the consideration would only be reduced when the person withdraws or uses in another way the amount with which her account has been credited.

Judge Greg Sinfield agreed with HMRC on the price reduction issue. Where the original amount has been received by the supplier, the taxable amount cannot be reduced under art.90 until actual repayment is made.

This conclusion made it strictly unnecessary to consider the contractual liability issue, but the judge examined four different representative contracts and commented on whether he considered that the customers were entitled to refunds in each case.

On the basis of the price reduction issue, the appeals were dismissed.

First-Tier Tribunal (TC06094): *Inventive Tax Strategies Ltd (in administration) and others*

6.4.2 *Fleming* claim

A Scottish NHS Board made a claim for repayment of input tax incurred on taxable supplies by its laboratories during the period 1974 to 1997. Its appeal was heard in 2015 and 2016 by Judge Kenneth Mure, who unfortunately died before giving a decision. The decision was, with the agreement of the parties, prepared by the side member of the Tribunal, Peter Sheppard. His decision records the evidence and discussion in considerable detail.

The first contention by HMRC was that the claim now under dispute was "new", i.e. made after March 2009 and therefore time-barred. The Tribunal disagreed. The calculations and revisions had been made in the course of correspondence and discussion in the period since March 2009, but they all remained valid clarifications of an existing valid claim.

Next, the Tribunal accepted that the Board did make taxable supplies in the course of business throughout the period of claim. There were specific supplies that were not covered by the exemption, in line with the *d'Ambrumenil* decision of the CJEU.

However, it was not possible to draw a conclusion about the calculation of the claim. A figure had been agreed for the 2006/07 year, but the Tribunal could not accept that extrapolation of this figure back into the distant past could be justified. Extrapolation might be valid over a long period if there were at least some contemporaneous figures from prime records – for example, over a 25-year period, the Tribunal suggested that verified calculations could be carried out every 5 years and applied to the intervening periods, if there was no great variation. However, to take a figure from 2006/07 and apply it without any other evidence to all the years from 1974 to 1997 could not satisfy the balance of probabilities.

The appeal was therefore dismissed.

First-Tier Tribunal (TC05971): *NHS Lothian Health Board*

6.4.3 Transfer of business

Four businesses made *Fleming* claims in relation to the treatment of demonstrator cars. In each case, the claimant had sold its business to another company. There was therefore a preliminary issue as to whether the right to make the claim had also been transferred, or whether it was retained by the original taxable person.

In each case, there was a written sale agreement, and the judge (Jonathan Cannan) started by considering the rules for construing those contracts. He noted that "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. It is not permissible to take into account the subsequent behaviour or statements of the parties as an aid to interpreting their written agreement, except in four specific situations which did not apply in these cases."

The judge examined the sale contracts and the history of claims made by each dealer, together with some other relevant documents such as letters sent by one of the vendor businesses to its customers at the time. He concluded that, on the facts of each case, the whole of the assets had been transferred to the buyer unless explicitly reserved by the agreement. That included the right to claim VAT repayments. The appeals should all therefore be struck out for failure of the preliminary issue.

First-Tier Tribunal (TC06091): *Challacombe's Ltd and others*

6.4.4 Repayment supplement

In TC04200 (December 2014), the FTT determined preliminary matters in three appeals that would otherwise proceed separately. All the appellants traded in alcohol; they moved stock from the UK to bonded warehouses in the Netherlands, but were not registered for VAT in the Netherlands at the time. However, they were required to be registered, because the Netherlands has no threshold for traders in excise goods.

The effect of Sch.4 para.6 VATA 1994 was that the traders were deemed to make a supply of goods, even though the goods remained in the same ownership. They all claimed a repayment of UK input tax on the basis that they had made a zero-rated despatch. HMRC refused the claims on the basis that the despatch was not made to a registered trader in another Member State; the companies applied for and were granted retrospective registration, whereupon HMRC refunded the input tax.

The hearing was to determine whether the companies were entitled to repayment supplement in respect of the delayed repayments. For the purposes of the hearing, the parties broke down the preliminary issues into four questions:

Issue 1: Whether an exporting trader is required to be registered for VAT in the Member State to which the goods are exported in order for the supply to be zero-rated under reg.134 SI 1995/2518, or, if different, under the PVD?

Issue 2: If the answer to the Issue 1 question is "yes", what are the consequences on the validity of the relevant VAT return in which a VAT credit was claimed in respect of the supply to the other Member State?

Issue 3: If the answer to the Issue 1 question is "no", having regard to the fact that Issue 1 has yet to be determined by the courts, does an inquiry by HMRC on the basis that the exporting trader was required to be registered in the other Member State amount to a reasonable inquiry under reg.198(a) SI 1995/2518?

Issue 4: If the answer to the Issue 3 question is "yes", how does this affect the determination of the beginning and end dates of the 30 day period in s.79(2A) VATA 1994 and any period left out of account?

Issue 1 turned on whether Notice 725 was entitled to insist that zero-rating was only available if the consignee was registered (imposing duties to check that the VRN was valid etc.). The PVD only requires that the consignee is a "taxable person in another Member State", which would include a person who is required to be registered.

The appellants accepted that the requirement in Notice 725 for the customer's VRN to be shown on a sales invoice was permitted by the PVD, so if there was a supply to a third party, it would not be zero-rated. However, this was a despatch without a change of ownership. No VAT invoice would be issued, so the requirement was not directly applicable. The company relied on the 1998 Tribunal decision in *Centrax plc* (VTD 15,743) in which despatches to an unregistered Italian branch were held to qualify for zero-rating.

After examining precedent cases including *'X' and Facet BV v Netherlands* (Cases C-536/08 & C-539/08), as well as HMRC policy as set out in manuals, Notices and their representative's argument, the Tribunal agreed with the appellants that it was not necessary for the consignee of a self-supply to be registered at the time of the movement in order to qualify for zero-rating. Requiring registration of the taxpayer in the other member state is irrelevant to ensuring the correct and straightforward application of the exemption and preventing evasion and avoidance. This is because the identity of the person acquiring the goods in the other member state is self-evident, given that this is a self-supply. Evidencing the despatch of the goods is addressed by the other conditions. The requirement for the recipient to be "registered", rather than merely "taxable", went beyond the PVD; the FTT agreed with the *Centrax plc* decision.

The answer to issue 1 was therefore "no", and issue 2 fell away. In respect of issue 3, the essence of the question was whether it was reasonable for HMRC to open an enquiry into the appellants' claims for input tax. The Tribunal concluded that it was.

In respect of issue 4, HMRC stated that they will treat enquiries on zero-rating as raised the day after the date of the first letter inquiring about why the appellants treated the disputed supplies as zero-rated. The appellants submitted that the clock should restart at the earliest point when HMRC could have accepted the appellants' arguments that the returns were correct. HMRC submitted that the enquiries ended for the purposes of s79(4)(b)(i) when HMRC satisfied themselves that they had received complete answers – namely when HMRC were satisfied that the

Appellants were in fact registered for VAT in the Netherlands. This would be some time after the responses were actually received from the traders, because HMRC would still have to "be satisfied".

The Tribunal noted that the start date in s.79(4)(a) is before that in reg.199(a) – it is when HMRC decide that it is necessary to make an enquiry. HMRC's actual approach is consistent with reg.199, which is more generous to the trader.

As regards the end date, the Tribunal ruled that both submissions were wrong. The consideration of responses by HMRC should be carried out within the 30 days. The clock should restart on the day that HMRC were satisfied that they had received full answers to the questions they had raised, not when they had completed their analysis of those answers.

The preliminary Tribunal decision ended with a summary of the issues and the responses, which should significantly clarify the rules on repayment supplement for the future.

The first of the substantive appeals has now been heard. The company, which operated a large cash and carry business in Cardiff, appealed against a refusal to pay repayment supplement of £26,045 in respect of its 10/2010 return period. The return was filed on 25 November 2010, claiming a repayment of £520,902. HMRC had already entered it into a "drinks project", which was a co-ordinated enquiry into the incidence of missing trader fraud in supply chains of duty paid alcohol products.

The decision records the slow progress of the verification of the return, which culminated in the repayment being made in full in three tranches on 15, 18 and 22 June 2012. HMRC argued that the clock stopped when they raised enquiries on 2 December 2010; they only received full answers to those enquiries on 30 May 2012, which meant that the count of days was 23, 26 and 30 days (HMRC using the dates of issuing written instructions for payment rather than the dates on which the claimant received the repayments).

The appellant made two main contentions:

- in respect of the whole enquiry, some days should be excluded because HMRC were not actively pursuing their enquiries during that time (in particular, 16 December 2010 to 14 February 2011 and 23 April 2012 to 30 May 2012);
- alternatively, in respect of one particular matter, an interim repayment of £99,100 could have been made in April 2012, and no reasonable enquiry was being made in respect of that part of the claim after that date.

In support of the first contention, the company argued that full answers to the enquiries made on 2 December were given by 16 December, and there was no indication that HMRC were not satisfied until different officers asked further questions on 14 February. By 23 April 2012, the only matter outstanding was confirmation that the company had applied for registration in the Netherlands. The company argued that this was not something that should have led HMRC to refuse the repayment. In any case, it was not a matter of enquiry, because it was not a question or a request for information. In waiting for confirmation that the company was registered in the Netherlands, HMRC were not undertaking reasonable enquiries but were rather seeking to challenge the liability of its supplies.

The £99,100 was not subject to the confirmation of the Netherlands registration, and there was therefore no outstanding point at all in relation to that after 23 April 2012.

The Tribunal (Judge Amanda Brown) noted the unfortunate history of the repayment supplement provisions: following the *Rowland* case in 1992, s.79 was amended, but SI 1995/2518 regs.198 and 199 were not. The case law since then has dealt with many disputes arising from the inconsistencies between the statute and the regulations. The judge summarised the approach she derived from the precedents:

(1) The aim of repayment supplement is to ensure that HMRC are diligent in processing and making payment of VAT reclaims. However, the 30 day period in which HMRC can reasonably be expected to process diligently claims must be balanced by a reasonable expectation that they have the information and documentation reasonably necessary to verify the claim Marlico Ltd [2015] UKFTT 528 paras 77 and 78)

(2) The subjective approach of the primary legislation is to be adopted when determining the start and end dates of the period during which the clock has stopped (Purple International VTD 18243 para 23, Cellular Solutions (T. Wells) Ltd VTD 19903 para 8)

(3) In order to constitute an inquiry HMRC must be contemplating return specific inquiries and not some general investigation (Purple International VTD 18243 para 26, Cellular Solutions (T. Wells) Ltd VTD 19903 para 9).

(4) It is possible to have multiple inquiries which may be successive or simultaneous relating to a single period (Cellular Solutions (T. Wells) Ltd para 12)

(5) An inquiry must be a question (Cellular Solutions (T. Wells) Ltd para 14 from L Rowland & Co Retail Ltd; Raptor Commerce Ltd [2010] UKFTT 335 para 56)

(6) An inquiry may be made of any person including another officer of HMRC (S&I Electronics plc VTD 20078 para 37, Raptor Commerce Ltd para 68)

(7) The repayment supplement clock stops running against HMRC when the officer forms an opinion that it is necessary to ask questions of someone (S&I Electronics plc para 37)

(8) An inquiry will be reasonable provided that the questions are proportionate and not prompted by an ulterior motive that is of no immediate relevance to the verification of the claim (Alliance & Leicester plc VTD 20094 para 18)

(9) An inquiry will be unreasonable where HMRC seek information that they know the taxpayer will not have and cannot obtain (Marlico Ltd para 82)

(10) The repayment supplement clock will begin to run against HMRC again when the Commissioners are satisfied that they have a complete answer and not when they have considered the information and concluded whether repayment is appropriate (Alliance & Leicester plc para 21)

(11) The burden of proof rests with HMRC to show when the clock should stop running against them (Marlico Ltd para 81)

(12) The clock finally stops once the payment is authorised (see para 122 – 129 below for detailed discussion on this issue).

The judge noted that the start date should be the date that the parties had agreed on in advance, 3 December 2010, the day following the issue of the letter raising the enquiry. She went on to conclude from the evidence that a complete answer to the enquiries raised was not given by 16 December, so the company should have known that the matter was unresolved.

The issue of whether the requirement to be registered in the Netherlands was a proper matter for enquiry stopping the repayment supplement clock had come before the preliminary tribunal. The problem was that the tribunal had decided that the failure to register in the Netherlands would not, on its own, make the supplies standard rated; however, given the uncertainty of the law in this area, the judge had ruled that it was a reasonable thing for HMRC to enquire into. Before the later tribunal, the appellant had essentially argued that "it was unfair for the taxpayer to have to bear the cost of HMRC's mistaken view of the law", and had not really engaged with the question of whether the enquiry was reasonable. Whatever the views of the two parties, the judge concluded that HMRC had all the information required to be satisfied about the registration liability in the Netherlands by 15 December 2011. However, she also considered that insisting on the production of a Netherlands registration certificate was a reasonable enquiry, and it kept the clock stopped until the certificate was provided.

According to HMRC, this was on 30 May 2012. However, the judge concluded that the documentation and explanations had been provided on 28 May, and there was no reason for HMRC not to recognise immediately that it fully answered their last outstanding question.

In relation to the argument that supplement should be paid in relation to the £99,100, HMRC argued that there is only one claim, one enquiry and one clock. There is no requirement for HMRC to make a partial payment. The judge disagreed, on the basis of the precedent in *R (on the application of UK Tradecorp) v HMRC*. In a judicial review case, the High Court had held that part payment should be made during the course of an enquiry if and when it is established that some of a claim is valid. Lightman J identified a number of factors to be balanced in deciding whether to make such an interim payment, but the presumption should be that the taxpayer would be entitled to the money unless there was a good reason to withhold it. The judge was satisfied that there was no outstanding enquiry on this particular issue after 23 April, and that repayment supplement should be paid on the £99,100.

The "written instruction" was held to be the authorisation by a particular officer to make the payments on 6 June 2012. What happened on 30 May was a request for authorisation, and what followed was administrative procedures. The clock therefore finally stopped on 6 June.

The final conclusion was that:

- the return was submitted on 25 November 2010;

- the clock was stopped in respect of most of the repayment from 3 December 2010 to 28 May 2012;
- the clock was stopped in respect of the £99,100 from 3 December 2010 to 23 April 2012;
- the repayments were authorised on 6 June 2012;
- that meant that the count reached 51 days for the £99,100, but only 18 days for the remainder.

Repayment supplement should be added at 5% to £99,100.

First-Tier Tribunal (TC06020): *Global Foods Ltd*

6.4.5 Updated Notice

HMRC have revised their Notice *Treatment of VAT repayment returns and supplements*. It includes updated information on how HMRC records the date of receipt of repayment returns, whether submitted online or on paper. The counting of days between submission of return and repayment is often disputed in relation to claims for repayment supplement. The procedure on receipt of a repayment return is described as follows:

Step	
1	Our computer system will record the date you submit your return through your online account. If you have been approved to submit paper returns the date we receive your return will be recorded on our computer system.
2	Automated credibility checks – These tests are applied to all claims. The majority of returns pass these tests and proceed immediately for payment.
3	Credibility queries – Returns that fail the automated tests are checked manually and are either resolved by the credibility team, or sent to specialist officers that deal with VAT for further investigation.
4	Returns sent for further checks – High priority is given to these checks and any queries are answered with the minimum involvement or inconvenience to your business. If we need to visit you, we will arrange it for a mutually convenient date and time.
5	Credibility queries returned to the credibility team – Results of VAT officer action, including amendments, are returned with a certificate detailing the amount of time taken and any official delay. Claims are passed for payment.
6	Payment of the claim – Once a claim has been accepted, repayment is made by direct payment to your bank. Our computer checks whether repayment supplement is applicable and if it is, the supplement is paid automatically at the same time as your repayment. You can find further information about repayment supplement in section 3 of this notice.

Notice 700/58

6.5 Timing issues

Nothing to report.

6.6 Records

6.6.1 Updated Notice

HMRC have issued a revised version of their Notice *How to correct VAT errors and make adjustments or claims*. The only highlighted change is a new address for HMRC's VAT error correction team in Newcastle.

Notice 700/45

6.7 Assessments

6.7.1 Extrapolation

A company selling second hand mobile phones and accessories appealed against an assessment for under-declared sales, road fuel scale charges and related penalties. An assessment for £93,305 had been raised in May 2015, but it was withdrawn on review and replaced by assessments for only £405 (road fuel) and £3,388 (sales misrecorded as returned goods). Penalties of £56 and £661 were added, but they were suspended and the taxpayer decided not to appeal against them further except to the extent that they depended on the outcome of the appeal about the VAT.

The decision on the road fuel was straightforward: the appellant had produced no evidence to back up its assertion that the car was used solely for business purposes, so claiming input tax on fuel without accounting for scale charges had to be wrong. That part of the appeal was dismissed.

The judge considered the methodology of HMRC's extrapolation exercise leading to the assessment in relation to returns, and various criticisms of the approach raised by the taxpayer. He considered that the assessment was raised to best judgement, but the value attributed to the returns was too high – the average value used of £242 was replaced by the judge's figure of £50. Presumably that would reduce the assessment in proportion to about 20% of the starting figure.

The appeal was allowed in part.

First-Tier Tribunal (TC06080): *Best Buy Communications Ltd*

6.7.2 Time limits

In TC04536, assessments and dishonesty penalties levied on a grocery and off-licence were upheld in principle, subject to submissions on whether the assessments had been raised in time. The question in TC05056 was whether the assessments had been raised within one year of HMRC having evidence of the facts "sufficient in the opinion of the Commissioners" to justify the making of the assessments. That second decision (in favour of HMRC) has now been the subject of an appeal to the Upper Tribunal.

The FTT referred to the CA judgment in *Pegasus Birds Ltd* as the leading authority on the issue. Aldous LJ set out the following principles:

1. The commissioners' opinion referred to in s 73(6) (b) is an opinion as to whether they have evidence of facts sufficient to justify making the assessment. Evidence is the means by which the facts are proved.

2. The evidence in question must be sufficient to justify the making of the assessment in question (see Customs and Excise Comrs v Post Office [1995] STC 749 at 754 per Potts J).

3. The knowledge referred to in s 73(6) (b) is actual, and not constructive knowledge (see Customs and Excise Comrs v Post Office [1995] STC 749 at 755). In this context, I understand constructive knowledge to mean knowledge of evidence which the commissioners do not in fact have, but which they could and would have if they had taken the necessary steps to acquire it.

4. The correct approach for a tribunal to adopt is (i) to decide what were the facts which, in the opinion of the officer making the assessment on behalf of the commissioners, justified the making of the assessment, and (ii) to determine when the last piece of evidence of these facts of sufficient weight to justify making the assessment was communicated to the commissioners. The period of one year runs from the date in (ii) (see Heyfordian Travel Ltd v Customs and Excise Comrs [1979] VATTR 139 at 151, and Classicmoor Ltd v Customs and Excise Comrs [1995] V&DR 1 at 10).

5. An officer's decision that the evidence of which he has knowledge is insufficient to justify making an assessment, and accordingly, his failure to make an earlier assessment, can only be challenged on Wednesbury principles, or principles analogous to Wednesbury (see Associated Provincial Picture Houses Ltd v Wednesbury Corp [1948] 1 KB 223) (see Classicmoor Ltd v Customs and Excise Comrs [1995] V&DR 1 at 10–11, and more generally John Dee Ltd v Customs and Excise Comrs [1995] STC 941 at 952 per Neill LJ).

6. The burden is on the taxpayer to show that the assessment was made outside the time limit specified in s 73(6) (b) of the 1994 Act.

The essential difference between the parties was this: the appellant considered that HMRC had had all the information that formed the basis of the assessment (business records etc.) after their last visit to the premises on 4 September 2009; HMRC regarded a 20 April 2010 PN160 meeting at their offices, involving the appellant and his tax agent, as significant to the raising of the assessments. The Tribunal considered the different points of view in some detail, and accepted the officer's view that he had received important information at the meeting, without which the assessment could not have been raised. The assessment and penalty were confirmed as raised in time, and the appeal was dismissed.

The taxpayer appealed to the Upper Tribunal, which noted that the only point of contention was whether HMRC had sufficient information to raise the assessment after the meeting on 4 September 2009. The officer said that he had attached little weight to what he was told on that occasion, because the visit had been carried out around midnight and without the taxpayer's agent being present. The taxpayer argued that the information provided on 4 September 2009 – that receipts for mobile phone cards and top ups were accounted for separately, not through the till – was sufficient for the officer to have raised a best judgement assessment.

The Upper Tribunal considered that the FTT's view of whether the officer had sufficient information on which to base an assessment was a finding of primary fact. The appellant therefore needed to show that it was based on an error of law, or it was not open to the FTT to come to the conclusion it did on the evidence before it.

The judges considered the evidence given by the officer in the FTT in some detail, and the arguments put forward by the taxpayer's representative that:

- the FTT had failed to appreciate that the April meeting only confirmed matters that the officer already knew, so he could have raised the assessment earlier;
- the officer's view, that he could not reasonably raise an assessment without a further meeting, was itself infected by an error of law, because it was a misunderstanding of the level of knowledge required for a "best judgement assessment".

After due consideration, the judges decided that the conclusions of the FTT could not be said to be perverse. They concluded with the following comment:

"*Mr Spranklen is to be commended for following an approach which was designed to be scrupulously fair to Mr Rasul. It is obviously highly desirable that HMRC's Officers should be seen to be scrupulously fair in the way that they approach the question of best judgment assessments and it would be highly undesirable if the law was to be interpreted in such a way that it operated as an encouragement to make an assessment in circumstances where there is any doubt as to whether the taxpayer has been treated fairly.*"

Upper Tribunal: *Rasul v HMRC*

6.7.3 Best judgement

HMRC assessed a company to a total of £66,562 covering 9 periods from 06/2012 to 12/2014. The decision commences with that statement, but the eventual conclusion refers to a further 6 periods from 12/2010 to 03/2012. The effect was to disallow the excess of input tax over output tax claimed over these periods on the grounds that the company was not trading. The appeal was heard in the absence of the taxpayer, having been postponed twice before. A further application to postpone was refused, on the grounds that no medical evidence of ill health had been provided, and the company had had plenty of time to present written submissions to the Tribunal.

The judge (Amanda Brown) described the relationship between the appellant's director and HMRC as "tortured". The company had submitted a series of repayment returns which were subject to extended verification by HMRC, and the director had continuously failed to provide access to the records that she said she held to back up the returns. HMRC therefore assessed to disallow all the input tax, while still collecting output tax. This represented a change in policy: up to 06/2012, HMRC would rather reduce a disputed repayment return to nil, on the assumption that the trader was not in fact trading.

The Tribunal agreed that HMRC were correct to disallow a great deal of the input tax. However, the judge considered that the fact of trading suggested that there probably was some input tax to claim. In the interests of scrupulous fairness, she suggested that the assessments for 09/2012 onwards should be reduced by 5% to allow for some notional input tax credit.

For the periods before that, HMRC were clearly wrong to regard the trader as not trading. The assessments reducing both output tax and input tax to nil were therefore misguided. On the other hand, they effectively erred in the taxpayer's favour – if the same basis had been applied as the judge thought appropriate for later periods, the assessments would have been higher. In those circumstances, the judge decided to dismiss the appeals in respect of the periods from 12/2010 to 06/2012.

First-Tier Tribunal (TC06102): *Bonomini Associates Ltd*

6.8 Penalties and appeals

6.8.1 Default surcharge

A firm of solicitors appealed against a surcharge of £529 charged at 5% for their third default. They disputed whether HMRC had properly served the SLN for the first or the second period. HMRC's records showed that their 03/16 return was not received until 30 May; the next two returns were each received just one day late, with payment collected by DD three days after that. The trader noted that HMRC had collected the DDs on the 11th of the month in the second and third cases; they had never collected it earlier than that in any previous month when the return was on time. They were also sure that the second return had been submitted on time, so if they had received a SLN they would immediately have protested about it.

HMRC's computer showed that the 06/16 return had been logged as received on 08/08 at 07:12. The 09/16 return had been logged as received at 05:51. The partner who submitted the returns accepted that 09/16 was late, but asserted that she had submitted it at 2am, and was adamant that she had submitted the 06/16 return before midnight. She claimed that it was clear that HMRC's computer did not log the returns as received at the same time that they were submitted. The judge noted that the last day for submission would always be busy for HMRC's computers. He accepted the word of a solicitor that the return had been submitted before midnight.

The judge decided that, on the balance of probabilities, the SLNs had been sent and received; the firm said that the late submissions were due to staff leaving, and HMRC argued that SLNs without a financial consequence might not have been recognised as significant. An argument based on proportionality was routinely rejected.

HMRC argued that the appellant could not now appeal, if they ever could, against the issue of the SLN with no liability to surcharge for 06/16. The judge disagreed, because it was material to the surcharge under appeal, and admitted an appeal out of time. He concluded that the trader had submitted the return at 2200 as she said, and that she had a reasonable expectation that it would arrive in time. There was therefore no default.

The judge went on to consider in detail the argument that HMRC's practice of collecting DDs after the 10th of the month in some way excused the late return, or established a practice that meant the payment was not late. He concluded that the legislation required payment by the 7th, and HMRC's practice of collecting the payment later was discretionary and could not be relied on for any purpose by the appellant.

The end result was that the 09/16 surcharge would have to be recalculated at 2%, which brought it below £400 so it should be cancelled. The appeal was allowed to that extent.

First-Tier Tribunal (TC05968): *Bradley Saul*

A company appealed against surcharges for 12/15, 03/16 and 06/16, charged at 5%, 10% and 15%, and amounting to £7,866, £15,866 and £24,960. The trader had used TTP in 03/15, but had continued to be late thereafter without agreeing TTP. The company argued that it was owed large CIS repayments by HMRC, and it was unfair and disproportionate to charge surcharges for late payment when set-off ought to have been allowed. Its cash flow difficulties arose from circumstances beyond its control, being the CIS system and the terms of business imposed by its major customer.

The judge agreed with HMRC that these were not unexpected or unforeseeable events, but part of the normal hazards of trade in the construction industry. There was no right of set-off in-year between CIS and VAT liabilities. The company should have planned better. The appeal was dismissed and the surcharges were confirmed.

First-Tier Tribunal (TC05975): *East Midlands Contracting Ltd*

A company appealed against a 15% surcharge of £4,864 imposed for its 08/16 period, when it paid a week late. There were 18 prior defaults from 05/11 to the period under appeal. 4 periods were subject to ongoing TTP agreements, with all the VAT still outstanding. The company claimed that late receipts from customers constituted factors outside its control.

HMRC responded that there appeared to be sufficient "headroom" in the company's overdraft facility to pay the VAT on time. There was little difference between the company's financial position on 7 October when the VAT fell due and 14 October when it was paid. The judge agreed, and dismissed the appeal.

First-Tier Tribunal (TC06015): *Astec Systems Ltd*

A company appealed against surcharges levied at 5% and 10% for its return periods 04/16 and 07/16, amounting to £881 and £1,670. The payments were made one day late in each case. The company argued that it had cash flow problems beyond its control, including the increase in the minimum wage and compulsory pension contributions for staff; the proprietors had attempted to organise loans from family members and credit cards.

The judge decided that the raising of the short-term loan from family, which allowed payment of the 04/16 liability one day late, constituted a reasonable excuse (although it appears rather to be "a reasonable course of action in response to difficult circumstances"); although a substantial late payment from a customer was received on 8 September, allowing settlement of the 07/16 liability the same day, there was no similar action to try to mitigate the situation. The appeal was allowed in respect of 04/16 but dismissed in respect of 07/16, except to reduce the penalty rate to 5%.

First-Tier Tribunal (TC06017): *Prada Contract Services Ltd*

A company appealed against a surcharge of £5,970 for its 02/16 period. The appeal had been postponed several times, and was eventually heard in the absence of any representative from the taxpayer after another request to postpone made only the day before the hearing. The company had argued in correspondence that the payment had been made on 7 April, but HMRC's representative produced a bundle of evidence to show that it was not (and could not have been, as the bank statement showed there would have been insufficient funds before a transfer of £50,000 from a different account on 8 April, after which the VAT was paid).

The company put forward other excuses, but these were held by the judge to be insufficient or irrelevant to the period under consideration. The appeal was dismissed.

First-Tier Tribunal (TC06018): *Blackhawk London Ltd*

A company appealed against five surcharges for periods from 08/14 to 11/15. The company protested that it had always informed HMRC when payments would be late and when they would be made; however, it did not formally ask for TTP (until period 08/15 when the request was made after the due date), and this therefore did not help. The evidence presented by the appellant in relation to various specific problems was not sufficiently detailed, and the overall arguments about fairness could not succeed. The appeal was dismissed.

First-Tier Tribunal (TC06032): *DH Project & Support Services Ltd*

A company appealed against a 10% surcharge of £1,636 imposed for its 10/16 period. The director was hospitalised at the beginning of December. He managed to submit the VAT return electronically on the due date, but was unable to access the banking facilities until the following day.

HMRC considered that the various circumstances described were sufficiently foreseeable to rule out reasonable excuse. However, the judge considered that the submission of the VAT return told a different story: the director was doing his best, and thought that he would be able to submit the return and the payment, but must have come up against an unexpected difficulty. In spite of no attendance by the company at the hearing, which meant that the nature of this difficulty could not be established, the judge decided that the company had shown a reasonable excuse. The appeal was allowed.

First-Tier Tribunal (TC06073): *Sky Throne Ltd*

Two related companies appealed against surcharges of £1,580 and £7,426, both calculated at 10% for periods ending 11/16. The companies had the same managing director, and they appealed on the basis that he had had an undiagnosed illness that constituted a reasonable excuse. By the time of the hearing, the company's representative recognised that there was no reasonable excuse for 11/16, but the Tribunal accepted that there was a reasonable excuse for 11/15 and 02/16, before the managing director's brain tumour had been diagnosed. His ability to make sound business decisions was impaired, but no one in the company yet knew that. Those surcharges were struck from the record, reducing the 11/16 charges to 2% (at which level the smaller one would not be collected, as below £400). The appeal was allowed in part.

First-Tier Tribunal (TC06075): *Hardy Access Services Ltd and another*

A company appealed against a surcharge of £16,213 in relation to its 09/16 period. The company had submitted the return early, on 27 October; it had believed that the tax would be collected by direct debit, because it had set up direct debits for a number of TTP agreements. However, the DDs related only to the agreed instalments under those agreements, not to liabilities generated by subsequent returns. The company said the bank had told it that the DD covered other liabilities. When the company realised that the VAT had not been paid on 7 November, it paid it immediately on 10 November. This was the same day that HMRC would have received it had they operated a DD.

A similar confusion had arisen in the 09/13 period, when the DD had been cancelled but the bank had told the company it was still current. HMRC had accepted that as a reasonable excuse and had agreed to cancel the surcharge.

HMRC agreed that this was a "genuine mistake", but did not constitute a reasonable excuse. The letter accompanying the TTP agreement pointed out that it did not cover future liabilities, which had to be paid on time. The judge considered the arguments finely balanced, but after taking into account all the circumstances, decided that they were tilted slightly in favour of the appellant. It was particularly relevant that the director had not simply assumed that the DD was in place, but had checked with the bank. The appeal was allowed.

First-Tier Tribunal (TC06088): *Spiral Packs (London) Ltd*

A company appealed against a 15% surcharge of £903 for being one day late with the payment for the 10/2016 period. The business had been in default in four periods from 07/2015 onwards. The decision records that the first default led to the commencement of a surcharge liability period (suggesting that the business had turnover above £150,000), and the 2%, 5% and 10% surcharges were all waived because they were below £400. That is surprising, as 10% surcharges are normally collected. It appears that this 15% surcharge is the first that the company was required to pay.

The director's appeal was based only on "getting muddled up with dates". This could not constitute a reasonable excuse, and the appeal was dismissed.

First-Tier Tribunal (TC06099): *Disaster Recovery Northampton Ltd*

A company appealed against 15% surcharges of £1,233 for being late with the payment for the 06/2016 period, and a surcharge of £810 for being late for 09/2016. In both cases, payment was made by Faster Payments, and arrived one day late. Unfortunately, the taxpayer's bank was not a direct participant in FPS: although the payments left the taxpayer's account before the due date, it did not arrive until afterwards.

The Tribunal decided that, given that it was within the surcharge regime, the taxpayer should have taken more care to make sure that the payments would arrive on time. The bank's failure to process Faster Payments on the same day was not a reasonable excuse.

First-Tier Tribunal (TC06106): *M L Tiles Ltd*

6.8.2 Other penalties

In TC04860, the FTT made an important decision about the special reduction for penalties that result in "delayed tax". That decision went against the taxpayer, but it has now been overturned by the Upper Tribunal. Rather than looking at the error in a particular return period and charging the penalty in relation to it in isolation (e.g. at 35%), the fact that the error reverses in a subsequent period is taken into account; the potential lost revenue is calculated at 5% per annum, i.e. for an immediately reversing error, 3/12 of 5%. The difference in this case was between a penalty of £149,000 and one of only £1,865.

The taxpayer was a plant and equipment hire company. The inaccuracy penalties were charged for the period from 1 December 2009 to 31 August 2013. The company accepted that penalties were due, but disputed the calculation of Potential Lost Revenue (PLR). The company argued that this should be computed under the arrangements for "delayed tax" under para.8 Sch.24 FA 2007.

At a VAT visit in December 2013, the company's external accountant provided a schedule of errors that had occurred over a number of years. In each quarter, the last day of input and outputs was omitted, and included instead in the following quarter – which would contain the same error. This appeared to result from the software "default date" for preparation of VAT returns being set to run from the last day of the previous quarter to the day before the last day of the current quarter, rather than the correct period. It seems that this was deliberately done to ease cash flow difficulties; presumably large numbers of rental payments were due to be received on the last day of a month, so exclusion of a single day had a disproportionately large impact on the figures.

It proved difficult to reprogram the computer. Even so, the company accepted that the penalty should be on the "deliberate, not concealed" scale for a prompted disclosure, with maximum mitigation for cooperation – a 35% penalty. HMRC aggregated the underpayments for the 15 quarters up to 11/13 (which was under preparation when the control visit happened, and was filed on the correct basis), and applied 35% to the total of £426,246.

Para.8 Sch.24 FA 2007 provides:

(1) Where an inaccuracy resulted in an amount of tax being declared later than it should have been ("the delayed tax"), the PLR is –

(a) 5% of the delayed tax for each year of the delay, or

(b) a percentage of the delayed tax, for each separate period of delay of less than a year, equating to 5% per year.

(2) This paragraph does not apply to a case to which paragraph 7 applies.

The effect of this would be to reduce the PLR to 3/12 x 5% x £426,246, and the penalty would become £1,865. The company wrote to HMRC in July 2015 suggesting that this was the correct approach in this case. HMRC responded:

Our guidance [CH82391] on delayed tax states that two conditions must be met for the delayed tax provisions to apply. These two conditions are:

Condition 1 – The nature of the inaccuracy is such that, when discovered, and without the person taking any action to correct it, the inaccuracy

- *has already been automatically reversed in one or more returns for a later period or periods, or*
- *would have been automatically reversed in one or more returns, but for HMRC intervention.*

Condition 2 – An amount of tax

- *is identified in the return for a later period that matches an amount which, but for the inaccuracy, would have been declared in the earlier period, or*
- *would have appeared in the return for a later period but for HMRC intervention.*

HMRC did not consider that Condition 1 was met. This was confirmed by a Review Officer, who based his confirmation of the decision on a reading of reg.34 SI 1995/2518. He considered that "when discovered" in Condition 1 referred to discovery by the taxpayer, leading to a deliberate correction: this had not happened. The officer stated that a deliberate error could not be "discovered" by the taxpayer – the taxpayer already knew it had been made. Only careless errors could be discovered and corrected within reg.34, so only careless errors could come within para.8.

On appeal to the FTT, the taxpayer argued that HMRC's position was based on their internal guidance, not the law. Even then, there were examples in their guidance that seemed to fit the current situation. The "discovery" in Condition 1 surely referred to HMRC discovering an error after it had been corrected in the following period, which corresponded exactly to what had happened in this case.

The judge (Dr Heidi Poon) examined the legislation in detail, including the structure and purpose of Sch.24 and its relationship with late payment penalties (where VAT is still subject to the "old" default surcharge rules) and corrections under reg.34. Crucially, only "careless" errors can be corrected under reg.34; the judge concluded that this meant only "careless" errors could be subject to the "delayed tax" PLR calculation.

The judge went on to note that error penalties are generally more severe than late payment penalties. If the company had filed correct VAT returns, and had simply paid the VAT as shown on its incorrect returns, it would have been subject to default surcharges totalling £63,697.

The judge commented on the difficulties caused by the expression "automatically reversed" in HMRC's guidance. This certainly appeared to support the taxpayer's case; however, the deliberately misprogrammed computer system was in effect "not automatic" in reversing the error – the taxpayer was constantly taking action in the next period to reverse the error, applying reg.34 when it was not entitled to do so. The judge said that it would be clearer if the guidance said that an error could only meet Condition 1 if it was "careless, not deliberate".

It appears that HMRC were prepared to accept the para.8 treatment in respect of the last quarter (08/13), on the basis of their own description of the operation of para.8 in circumstances where an enquiry by HMRC prevented the "automatic reversal" of an error in the next period (set out in *R&C Brief 15/11*). The judge said she would not interfere with such a concession, but could see no legal basis for it. The appellant had rightly pointed out that allowing this approach for 08/13 but not for the other quarters was inconsistent; the judge agreed that it was illogical and, indeed, ultra vires. The argument therefore did not assist the appellant.

The appeal was dismissed and the penalty confirmed by the FTT, and the company appealed to the Upper Tribunal. Mr Justice Mann and Judge Julian Ghosh noted that Dr Poon had arrived at her conclusion by applying a line of reasoning that HMRC had not advanced, and which they did not appear to support. The UT stated the competing arguments briefly:

The taxpayer argued that paragraph 8 applied according to its terms. The FTT found as a fact that, quarter by quarter, each inaccuracy in a previous quarter would be corrected by the inclusion of the last day of the one as the first day of the next. The inaccuracy was one and the same for the end and beginning of each period – it was not right to treat them as two separate inaccuracies on each occasion. To distinguish between the two faulty aspects of each adjacent return was to create a false distinction. There was the same inaccuracy on each occasion that the "last day" was moved from one return to the next because it was produced every time by the same mechanism.

Miss Wilson's argument for HMRC involved applying paragraph 5 in accordance with its terms and stopping there. There was an inaccuracy in each return when one day was erroneously left out of it. Where that resulted in an under-statement of tax due that was an "understatement of a liability to tax" within a paragraph 1 document, then one stopped there and calculated that amount on each occasion when it happened. The "inaccuracy" at the beginning of the next period was a different inaccuracy, and did not affect the calculation made in respect of the preceding period. Taking the two inaccuracies together and treating them as one would involve taking the intention of the taxpayer into account, and there was no justification for doing that at the initial assessment stage. That only came in at the later calculation stage under paragraph 4(2) when one looked at the quality of the error. She pointed *to various examples given in Revenue practice statements which she said supported her case.*

The resolution was equally brief. The judges agreed that para.5, read on its own, supported HMRC's conclusion. However, that was not the question: rather, it was necessary to consider whether para.8 applied. Para.8 always required consideration of two returns – otherwise there could not be "delayed tax". The judges also emphasised the condition in para.8 that the first error "resulted in" the delayed tax. This meant that there had to be a direct causal relationship between the two errors. HMRC offered the systematic understatement of closing stock as an example of when para.8 would apply; the judges agreed, and considered it directly analogous to the present case. By contrast, the case of *Miah* (TC05377), in which the trader chose to declare income several periods late, was an example of conduct that did not have the right causal link.

The UT also commented that if HMRC were right in considering the first penalty on its own, para.8 "would have no work to do". HMRC's submission that the trader was "penalty shopping" was hard to understand. The trader's conduct was dealt with by charging a higher rate of penalty under para.4, rather than by choosing between different calculations of the PLR in paras.5 and 8.

The appeal was allowed.

Upper Tribunal: *M J Hickey Plant Hire and Contracts Ltd v HMRC*

An individual appealed against a penalty for late notification of liability to register. He was represented at the appeal by his current accountant, but did not appear or provide a witness statement. As the facts of the case predated the representative's appointment, it was difficult for the Tribunal to make relevant findings of fact.

The previous accountant had written an apologetic letter to HMRC in May 2016, taking the responsibility for failing to notice that his client's turnover for the year ended April 2014 had exceeded the VAT registration threshold. The trader said that he had asked his accountant "on a number of occasions" whether he ought to have been VAT-registered, and accepted his word that he did not have to be.

The judge could make no findings about the taxpayer's questioning of his adviser. She noted, however, that he had not taken any steps to verify the advice, even though he appeared to have misgivings about it. Many of the other sub-contractors he worked with were VAT registered. It appeared that in relation to another question on which he sought the agent's advice – the appropriate FRS VAT rate – he did consider taking a second opinion when he did not like the answer he was given. Overall, the judge did not consider that this was a situation in which "reliance on another" constituted a reasonable excuse, and the penalty of £2,772 was confirmed.

First-Tier Tribunal (TC06112): *Graeme Faulkner*

A trader appealed against a late notification penalty, pleading that a mistaken belief that supplies were zero-rated was a reasonable excuse. HMRC had enquired into his affairs in late 2015 and had concluded that he ought to have been registered from 1 November 2012. His accountant responded that he had made enquiries at the time and had been told that "protective clothing was VAT-exempt". He had therefore concluded that he did not have a liability to register. However, his only supplies that qualified for zero-rating were motorcycle helmets.

HMRC calculated the undeclared VAT at £23,962, and a penalty for non-deliberate failure with prompted disclosure of £4,792 (20%) was added. The Tribunal noted that there was no right of appeal against the assessment, in the absence of a submitted return; it had in any case been calculated on the basis of figures supplied by the taxpayer's accountant.

The trader claimed that he was told by his supplier, a reputable businessperson he consulted, and his accountant that his supplies of motorcycle clothing (as opposed to helmets) were zero-rated. He also claimed that a Google search suggested the same answer. The judge noted that he was at least aware that the VAT law might apply to him. The question was whether he had a reasonable excuse, given that "ignorance of the law" on its own was not a defence.

The judge appears to have carried out his own Google search, and found a link to the relevant public notice. This makes it clear that only motorcycle helmets and protective clothing for industrial use are zero-rated. It specifically refers to motorcycle boots being standard rated. It seemed that the taxpayer had a general belief that protective clothing was zero-rated, and had not done enough to discover the truth. That was not a reasonable course of action. The Tribunal had some sympathy for the trader, but had to dismiss the appeal.

First-Tier Tribunal (TC06005): *Nathaniel Hendrickson*

A company appealed against an assessment to VAT of £69, together with penalty assessments of £780, £8.85 and £10.35. The judge spelled out these amounts in words to emphasise that there was no typographical error. He went on to rehearse in detail the history of the enquiry that led to the assessments, in which it appeared that the HMRC officer had raised assessments and penalties without asking for evidence or explanations from the company. The judge was clearly astonished at the way in which the officer had acted, demanding excessive amounts of evidence in relation to small amounts, demanding hurried agreement to suspension conditions without making it clear what the conditions were, and taking a purely mechanical approach to the calculation and imposition of penalties. The officer was inconsistent about whether behaviour was deliberate or careless, and whether disclosure was prompted or unprompted.

The review appeared to further confuse the issues. The reviewing officer stated that the penalties were invalidly issued: the notices should be withdrawn and replaced with separate assessments for different periods. It appeared that this was never done, which meant that the appeal on the penalties had to be allowed. Even so, the judge considered the basis of the penalties in detail, in case he was wrong on the issue of validity.

In respect of one matter, HMRC had ruled that input tax could not be claimed because the company was a joint owner of some land and the VAT related to that land. In HMRC's view, joint ownership constituted a partnership, and was therefore a separate taxable person. The company had responded that there was no partnership, but "this fell on stony ground". The judge ruled that HMRC's view was not inevitably correct, and they had not asked any relevant questions to establish the facts. There was therefore no valid reason for the penalty assessment in this regard.

The officer's change from an initial view that disclosure was "unprompted" to "prompted" following the review was inexplicable and unjustified. There also seemed to be no basis for regarding the appellant's conduct as deliberate; it was possibly not even careless.

The taxpayer's responses with evidence amply supported a claim to VAT on road fuel, which was the subject of the £69 assessment. The judge went through the law and public notices to show that the company had done exactly what it was supposed to do.

In concluding, the judge said he was minded to make an award of costs against HMRC for "unreasonable conduct". Although every aspect of the case might appear to be unreasonable, the judge concentrated on one particular aspect: the failure to abide by HMRC's own policy as set out in the Litigation and Settlements Strategy (LSS). It appeared to the judge that the result of the review would have reduced the penalties to a total of less than £100, which the LSS would have regarded as too small to assess. This seemed to be the reason for the officer's change from "unprompted" to "prompted", which put the penalties back up to an assessable level. The change was not explained to the appellant; when it was questioned by the appellant:

"*they were given an explanation which simply beggars belief as an appropriate response. It involves a flagrant misreading of a passage from a VAT Notice and a complete ignoring of an admission Miss Pearce had made in the previous line. As Miss Pearce seems to have distanced herself from this explanation, we can only assume that it was dictated to her by her superiors. We consider, having thought about this long and hard, that there are two possible explanations for this volte face. One is that there was incompetence on a grand scale. The other is that there was a deliberate decision to keep the dispute alive, when on the basis of the reviewing officer's remarks it would have been discontinued, by seeking to revisit the 'prompted' issue. The facts that have caused us not to dismiss this possibility include the minimal information about the change with no explanation and the hopelessly muddled response with its spurious justification that Miss Pearce sent when the appellant spotted the change. Of course we have had no evidence from those involved and do not intend in this decision to make any findings about the matter. But it is something we have to take into account in deciding whether HMRC's conduct in this case was unreasonable*."

The judge commented that if HMRC wished to make representations about an order for costs, they should do so before 31 October. The appeal was upheld on all counts.

First-Tier Tribunal (TC06029): *Gekko & Company Ltd*

In TC04668, the FTT considered the case of an individual who was assessed to a penalty of £3.1m under s.61 VATA 1994 in respect of VAT losses connected to a company of which he was a director. The underlying alleged fraud was a contra-trading operation carried on in period 04/06; the amount the company sought to evade was £6.97m.

The appeal commenced with an application by the appellant for the judge to "recuse herself" from the appeal, based on her involvement in various directions hearings before the substantive appeal. She refused, and proceeded with the main hearing. This followed the usual course of

MTIC appeals, with the added element of considering whether the conduct involved dishonesty and that was attributable in particular to the individual director. There was a wide range of legal objections to the imposition of the penalty, all of which were rebutted in turn. The judge concluded that the penalty met the statutory criteria, and dismissed the appeal.

The individual appealed to the Upper Tribunal, arguing a number of points:

(1) In the absence of specific legislation, can a principle of EU law be used as the basis of penalising a UK taxpayer?

(2) Does s.60 VATA 1994, properly construed, permit a penalty to be imposed on a knowing participant in an MTIC fraud?

(3) Was the FTT's approach to the evidence correct in law?

(4) Would a reasonable person conclude that Judge Blewitt pre-judged matters in her summary judgment decision?

The first two grounds concerned whether the *Kittel* principle could be used as a basis for a penalty. The judges considered that this was misconceived: s.60 penalised the dishonesty, not the particular conduct involved. The taxpayer sought to suggest that the position of "buffer traders" was not clear until the *Kittel* judgment was delivered in July 2006; the UT was satisfied that there was a clear and unambiguous basis for a penalty in this case.

The criticisms of the approach to the evidence were rejected. The FTT had not placed the burden of proof on Mr Butt, but had simply noted that he had given no evidence so various questions remained unanswered. There was ample evidence on which a finding of dishonesty could validly be based.

The UT was also satisfied that the conditions that might have required Judge Blewitt to recuse herself from the hearing did not apply. The appeal was dismissed. The taxpayer's representatives were thanked for providing their help pro bono.

Upper Tribunal: *Butt v HMRC*

A company failed to file returns from 07/2010 to 07/2013, instead paying central assessments. Following an investigation, further assessments totalling £292,000 were issued. It was clear that there was very little evidence to establish the correct figures. The company was liquidated and the VAT itself was written off, but the sole director and shareholder was assessed to a penalty under s.61. HMRC allowed 20% mitigation for disclosure and 30% for co-operation, and demanded £146,000.

The Tribunal considered the director's protests about his innocence and the uncertainty of HMRC's figures, but concluded that his conduct met the required definition of dishonest conduct for VAT purposes. Mitigation would be increased to 25% and 35%, making a total of 60%, so the penalty was reduced to £116,855. Subject to that, the appeal was dismissed.

First-Tier Tribunal (TC05955): *Yunus Oomerjee*

The FTT has heard the first appeal relating to the Senior Accounting Officer regime contained in FA 2009 Sch.46. This imposes a requirement on certain companies to appoint a SAO, who has a “main duty” to take reasonable steps to ensure that a company establishes and maintains appropriate tax accounting arrangements.

The appellant was the finance director of a privately owned group of companies involved in currency exchange and financial services. It was partially exempt and operated a special method. After the appellant ceased to work for the company, its accountants submitted an error correction notification in relation to its VAT returns for the periods 03/2010 to 01/2014, estimating the overall net error at £1.36m.

HMRC imposed two penalties of £5,000 each on the individual. He appealed; the matter finally came before the FTT on 20 July 2017, after a meeting in January 2015 and penalty assessments raised in June 2015. The judge noted that the individual was unrepresented, and had received no support of any kind from his former employer. HMRC had cited “taxpayer confidentiality” as a reason for not giving the appellant any information about the error correction notice until it was provided as an exhibit to a witness statement during the course of the appeal.

The judge reviewed the SAO legislation and its purpose, as set out in an Impact Assessment at the time. There was some dispute about whether the appellant should have produced a written witness statement, or should have been allowed to make oral assertions of matters that he had not raised before. The judge considered it wholly unrealistic to expect a litigant in person, without any access to supporting documentation that might support his case, to be restricted in this way. She appreciated that it would be difficult for him to remember details from several years previously.

The appellant had worked for the group from 2005 as group financial controller, and became finance director in around 2007. He had left in 2014 following a disagreement about a matter not related to the subject of the current appeal. He explained that he had done what he could to improve accounting, and described the tax function as well as he could remember it. There was a tax policy document and a risk register, which he was responsible for keeping under annual review. He said that he relied on two members of staff who appeared to be adequately qualified and trained to carry out the preparation of the VAT returns; he also relied on KPMG’s annual audit. KPMG had been engaged to negotiate a new PESM in 2010, and had carried out detailed work on the records at that time to confirm that the result was fair and reasonable. The appellant had also engaged the firm to carry out a full review of tax arrangements in October 2013, in relation to a possible sale of the business; it was this work that ultimately led to the error correction that was filed after he had left.

The errors identified by KPMG fell under several headings. Input tax had been misclassified and allocated to partially recoverable sectors of the PESM, rather than being treated as wholly irrecoverable. Reverse charges had not been applied to supplies from two overseas third parties. In the error disclosure, KPMG suggested that the board had regarded the finance director as a key control and were “disappointed” that the errors had occurred.

The appellant argued that, had he been able to see the error correction notice and the terms of the letter at his meeting with HMRC in January 2015, he would have disputed points arising and would have responded very differently to HMRC's questioning at that time. According to HMRC's notes of the meeting, the appellant had described his checking of the VAT return as mainly based on variance analysis – that is, if there were systematic and recurring errors, he would not pick them up, because the return would appear consistent with earlier ones.

The judge agreed with the appellant that what he said at the January 2015 meeting had to be considered in the light of his restricted knowledge of the errors that had been made. Both before and at the hearing, HMRC had focused primarily on whether the appellant had a "reasonable excuse" for failing to fulfil his duty; however, that was not the proper starting point. The question was whether the appellant had taken "reasonable steps" – i.e. had fulfilled his duty, rather than having a reasonable excuse for failing to do so. Even though the judge agreed with HMRC that the nature and extent of the errors meant that the group did not have "appropriate tax accounting arrangements", that did not necessarily mean that the SAO had failed to "take reasonable steps".

The judge considered that, in the context of this business, the appellant's actions had been reasonable. He relied on an individual who received training and support from KPMG, supervised by a qualified and experienced accountant, in operating a system that had been designed and agreed with HMRC by KPMG. His "light touch" review might have been more detailed, but it was not unreasonable.

The judge concluded by making comments about HMRC's approach to the case. The effect of their concerns about taxpayer confidentiality was unfair to the appellant. It was also unfair to place heavy reliance on what the appellant said at a meeting where he was not given the full facts. HMRC had not made adequate allowance for the fact that the appellant was unrepresented and unsupported by his former employer. HMRC made no distinction between a company that was just over the SAO threshold (which it appears that this group was) and a much larger one with a large finance function. Lastly, their concentration on "reasonable excuse" effectively prejudged the issue of whether the main duty had been breached. This led to rejection of the appellant's protestations that he had asked for additional resources to improve controls – "lack of funds" cannot be a reasonable excuse. But the judge considered that asking for additional funds could be a "reasonable step", if those funds were refused.

The appeal was allowed and the penalties were cancelled.

First-Tier Tribunal (TC06043): *Kreeson Thathiah*

In TC02762, the FTT held a director liable for a s.60 penalty (£43,753, reduced from £47,270 on review) in respect of VAT claims by his company which were supported by falsified invoices. The case included the unusual point that HMRC had to vacate the assessment to collect the tax in respect of one period, because they had initially raised it for the wrong period and were out of time to raise a new correct assessment; however, according to the precedent case of *Ali t/a Vakas Balti* (CA 2007), HMRC were still entitled to base a s.60 penalty on the full amount of the tax which the trader had attempted to evade (successfully, in the end, because of HMRC's administrative error).

The director appealed to the Upper Tribunal. The FTT had not commented on the burden of proof, which lies with HMRC in a dishonesty case; rather, it had stated that it was "not convinced" by the director's explanations, which suggested that it had placed the burden on him. It was also questionable whether the director's actions in relation to the fabricated invoices were enough to constitute dishonesty – he had not been involved in fabricating them, but had simply submitted them to HMRC after obtaining what purported to be copies from the suppliers.

Mr Justice Newey held that it was not clear that the FTT had applied the law correctly. If it had done so, it should have explained the basis of its decision in much more detail to make it clear how the law was being applied. The appeal was allowed, and the case was remitted to the FTT for reconsideration.

The new panel comprised Judge Jane Bailey and Mr Mohammed Farooq. They started by emphasising that they were aware that the burden of proof was on HMRC to demonstrate that the company's conduct was attributable to dishonesty on the part of the director, based on the civil standard of "balance of probabilities".

The test for dishonesty was taken from *N'Diaye* (TC04562) and *Osman* (TC05273) (both duty penalty cases): "*the test for dishonesty in civil proceedings is ... primarily objective: was the behaviour dishonest according to normally accepted standards of behaviour? However, there is a subjective element. Mr Brookes' own understanding is relevant to our consideration of whether his behaviour was dishonest – we do not need to consider whether Mr Brookes was aware that his actions fell below what would be considered to be acceptable standards (assuming we find that to be the case) but we do need to consider whether Mr Brookes knew all the facts which made it wrong for him to act as he did.*" It was also necessary to consider that "*an honest person in such a case [does not] deliberately close his eyes and ears, or deliberately not ask questions, lest he learn something he would rather not know, and then proceed regardless.*"

The Tribunal examined the history of the overclaimed VAT, which related to various building projects. The director had been required by HMRC to submit copy invoices, which he obtained from suppliers, but he recognised that they looked nothing like the originals. He described them as "useless", but sent him to the advisor who had been dealing with the enquiry. The advisor sent them to HMRC without further comment. The director claimed that he had told the advisor that the documents were unsatisfactory, but neither HMRC nor the Tribunal considered it likely that a professionally qualified person would then send such documents to HMRC without further comment. The advisor had not been called to give evidence to either the original Tribunal or the present hearing, so did not have the opportunity to explain his conduct. The Tribunal concluded that the director had sent the documents to the advisor without further comment or explanation, knowing that they would be sent on to HMRC purporting to be copies of the originals. This would, in the opinion of "ordinary honest people", be dishonest.

The Tribunal also considered the director's subjective knowledge, as far as it could be inferred from his actions. It was clear that he had had the opportunity to say what he knew about the documents to HMRC much earlier than he did. The Tribunal did not regard his conduct as "thoroughly dishonest", but parts of it were dishonest, which was enough to confirm the penalty. The appeal was dismissed.

First-Tier Tribunal (TC06098): *Peter Brookes*

6.8.3 Barring HMRC from proceedings

The *BPP* case has reached its conclusion: the Supreme Court has upheld the decision of the Court of Appeal, which overturned the UT decision and restored the decision of Judge Mosedale in the FTT (TC03768) to bar HMRC from taking any further part in the proceedings.

First-Tier Tribunal

The taxpayer applied for HMRC to be barred from the proceedings for failing to follow Tribunal directions. The subject matter of the substantive appeal appears to be similar to that in *Kumon Educational UK Co Ltd and related appeal* (TC03249): a taxable education provider underwent a reorganisation, following which study material was supplied zero-rated by a different company (LM) from the standard rated education and training (Holdings).

On 29 November 2012 HMRC issued two alternative assessments on LM and Holdings of approximately £6 million for the period September 2008 to 18 July 2011 on the grounds that VAT should have been charged on the supply of the books on the bases either that there was a single composite supply, or that there was an abuse of rights. A further decision was issued stating that the 2011 changes to the zero-rating of printed matter applied from 19 July 2011. The company accounted for VAT on sales of printed matter from that date, but nevertheless appealed against the decision.

The two assessments and the decision were appealed in time. The three appeals were joined and directions issued for a joined statement of case ("SOC") to be served on 2 October 2013. HMRC applied for a short extension of time when the joined SOC was served late on 21 October. The appellants did not consider that the SOC satisfactorily explained the factual and legal basis for the two assessments and decision. The appellants applied direct to HMRC for further and better particulars on 11 November 2013. There was some correspondence and calls between the parties in which the solicitor acting for HMRC appeared to accept in principle that HMRC ought to give the replies requested but would not (yet) commit HMRC to a time frame in which the replies would be provided.

The appellants then applied on 22 November 2013 to the Tribunal for an order that unless replies were provided within 14 days of the date of the order HMRC would be barred from proceedings. A hearing was convened for 9 January 2014. By the end of December the parties were agreed that the replies were to be provided by 31 January 2014. However, HMRC would not consent to the order proposed by the appellant as it was in the form of an "unless" order which stated that HMRC would be barred if the replies were not provided by the agreed date of 31 January 2014. The hearing of 9 January therefore went ahead, and Judge Hellier issued an "unless" direction – it was slightly different from that requested by the appellant (under rule 8(1) – mandatory strike-out for non-compliance), but had a similar effect (under rule 8(3)(a) – discretionary strike-out for non-compliance). The wording was:

If the Respondents fail to provide replies to each of the questions identified in the Appellants' Request for Further Information by 31 January 2014, the Respondents may be barred from taking further part in the proceedings...

HMRC sent a request for further information on 31 January. On 24 April they notified the appellant that they were withdrawing the assessments (probably realising after the *Kumon* decision that they were hopeless), but maintaining the decision about the post-July 2011 position.

The January directions also required both parties to carry out a further disclosure exercise by 30 April and file a disclosure statement and further list of documents on the other no later than that date. There was no suggestion that the appellants did not comply. HMRC did not comply until 8 May 2014. On that date a disclosure statement was served together with a list of documents, which included no new documents. HMRC did not apply for an extension of time until 5 June, when they stated that there were no further documents to disclose.

Judge Mosedale examined in detail what Judge Hellier's direction had required HMRC to do, and what they had done in response to it. Although pleadings in general do not require each party to identify every fact, matter and submission with the same degree of particularity as will be relied on at the hearing, nevertheless it is open to the Tribunal to direct more detailed pleadings than ordinarily required and in this particular case, in accordance with the parties' agreement, that is what the Tribunal did. HMRC could have appealed against the direction or they could have sought to have it set aside; instead, they failed to comply with it. The direction required them to identify all the facts on which they sought to rely; their reply identified no facts at all.

The judge went on to consider the appropriate sanction. She agreed that the appellant was unable to appreciate HMRC's case or prepare to argue against it on the basis of the SOC and the reply to the direction. "Litigation should not be conducted by ambush." The judge could not understand why HMRC had failed to comply with the direction – in the absence of any clear reason, the failure could not be justified.

HMRC's representative pleaded that barring HMRC from the proceedings was a Draconian remedy that would allow the appellant to treat its supplies as zero-rated into the future, causing a distortion of competition. The case was supposed to be the first test of the operation of the 2011 legislation. None of these arguments held weight: HMRC could bring another test case, and they could issue a new decision from a current date that would have to be appealed again. There should be no special treatment of HMRC if they ignore the Tribunal's directions: "To say otherwise would mean HMRC (and perhaps appellants) have a licence to ignore Tribunal rules and directions where an HMRC decision in principle rather than an assessment or voluntary disclosure is the subject matter of the appeal."

The judge's decision was:

I have come to the conclusion that HMRC should be barred. There has been unnecessary delay and expense. Tribunal directions have been breached. There is clear prejudice to the appellant in having to wait 8 months for a proper statement of HMRC's case and not barring HMRC *would leaves the appellant without a remedy for this prejudice. There was no good reason for the delay in stating its case, the failure lasted for a significant period of time, and HMRC were clearly on notice from the first that the appellant did not consider their SOC satisfactory, and clearly on notice from January that a failure to comply might lead to a barring order yet they did not correct the position for another 5 months. Barring is the appropriate sanction.*

In theory, HMRC could maintain their decision, but they would not be able to appear or be represented at the hearing of the appeal. As they have still not put forward a cogent argument in support of their decision, this would be a substantial disadvantage. They are likely to concede this decision and issue a new one, and find another taxpayer to test the operation of the legislation.

HMRC then applied to a different FTT judge (Timothy Herrington) for the barring order to be lifted. The judge considered the basis of Judge Mosedale's decision and HMRC's criticisms of it, and concluded that it was only appropriate for the FTT to lift the barring order if:

(1) Factual circumstances have changed since Judge Mosedale's decision; or

(2) There was an obvious error of law in the decision.

The judge could find no such obvious error of law, and refused to lift the barring order (TC04031).

Upper Tribunal

HMRC appealed to the Upper Tribunal against the barring order. The Upper Tribunal judge (Colin Bishopp) agreed that Judge Herrington was correct not to lift the barring order: the proper place for a review of Judge Mosedale's decision was the UT, not the FTT.

HMRC's representative accepted that HMRC had failed to comply with Judge Hellier's original directions, and could not offer an explanation or an excuse for this. However, she claimed that there was no significant prejudice to BPP in the delay, which had been rectified before the hearing to consider the barring order. Such prejudice as there was could be remedied by an award of costs; the barring order had the effect of handing BPP an unwarranted windfall.

She went on to put forward five different criticisms of Judge Mosedale's decision. The first of these was that the judge had incorrectly applied the principles of the *Mitchell* case to the case before her. Judge Bishopp agreed that this was a material flaw in her reasoning – that was not her fault, because there were further developments in that line of case law after she had heard the application, and these showed that it was not applicable in the way that she had thought. In order to allow for the substantive appeal to proceed in the FTT in November, Judge Bishopp did not refer the matter back to the FTT, but instead "re-made" the decision in the UT.

He was highly critical of HMRC's failures in the case, but concluded that it was not appropriate to bar them from the proceedings. It was unsatisfactory that the FTT had so few sanctions to enforce its directions; but it should not necessarily impose the ultimate sanction for want of anything else. He did not make an order for costs at this time, but invited applications from the parties. He made the following comment in conclusion:

Miss Simor argued that I should instead make a direction for indemnity costs in HMRC's favour, since it should have been apparent to BPP, once the judgment in Denton and my own decision in Leeds City Council were released, that it should have agreed to the lifting of the bar. I do not think there is any merit in this argument. First, it does not seem to me that a party can be lightly criticised for defending a position in which it finds itself. Second, this was not a case of an inadvertent slip quickly corrected, or of an error, even if not quickly corrected, which was innocent and of little real consequence. It is a case in which there has been a prolonged failure to do what, as Judge Mosedale rightly said, it should have been obvious to any lawyer ought to be done. The prejudice to BPP of HMRC's conduct is not great, but it is real. It does not seem to me that BPP should be exposed to the costs of this application, and certainly not on the indemnity basis.

Court of Appeal

BPP appealed to the Court of Appeal. The issue before the appeal judges was the proper approach of the tax tribunals in the case of a breach of an order. It was established that:

- HMRC had not complied with the order;
- HMRC had not given any reason for their failure; and
- Prejudice had been caused to the taxpayer as 'litigation is not to be conducted by ambush' and HMRC's failure had caused significant delays.

BPP submitted that the UT could have given its own guidance to the FTT, rather than re-making the decision. The difference in wording of the Civil Procedures Rules and the Tribunals Rules did not suggest any difference of approach, and it had been the practice of the Tribunals for some years to consider the CPR for guidance; and the guidance in the *Mitchell* and *Denton* cases was as relevant to the Tribunals as it was to the courts. BPP contended that Judge Bishopp had been wrong to conclude that Judge Mosedale had given HMRC's non-compliance with the order too much weight in reaching her decision.

The appeal judges agreed. They noted that the UT is a superior court of record which can take its own view on interpretation and can develop its own precedent. There was no justification for a more relaxed approach to compliance with rules and directions in the Tribunals than in the courts. It was appropriate that compliance and the efficient conduct of litigation at a proportionate cost should be given the weight accorded to them by the FTT in this case.

Flexibility of process did not allow for a shoddy attitude to delay or compliance by any party. The correct approach for HMRC, if they were having difficulty with compliance, would be to discuss an alternative with the taxpayer, and make an application to the Tribunal for revised directions, explaining the reasons for non-compliance and the merits of the alternative proposal. In this case, HMRC had simply failed to do anything.

There was therefore no overriding policy argument that more leeway should be afforded to HMRC because of their special status. What was left was the question of whether Judge Mosedale had carried out the balancing exercise in an inappropriate manner. That was only subject to a test of "unreasonableness" on appeal. The Court was satisfied that the factors that weighed in BPP's favour had been properly assessed: not only had there been no good reason for non-compliance, there had been no reason at all; and prejudice had been occasioned as a consequence in the form of significant delay and expense. On the basis of those findings of fact, the balance was clear. Non-compliance had not been the only factor that had persuaded Judge Mosedale to grant the barring order. The lack of any reason for non-compliance and the finding of prejudice had also been relevant factors.

BPP's appeal was allowed, and the decision of the FTT was restored.

Supreme Court

HMRC appealed to the Supreme Court, which considered that a barring order was a matter for the FTT to decide. An appellate judge should only interfere with such a decision if satisfied that it was unreasonable; it was not enough that the appellate judge might have come to a different decision. It was therefore necessary for HMRC to show that Judge Mosedale was not entitled to come to the decision that she reached.

HMRC argued that Judge Mosedale had treated the "unless order" as if it had been issued under rule 8(1) rather than rule 8(3). The SC did not agree. She had carefully distinguished between the two, and had applied the right rule.

HMRC also argued that Judge Mosedale had incorrectly applied the CPR, which governed procedure in higher courts but not in the FTT. Again, the SC disagreed. She had been guided by the precedents and other rules, but had come to a proportionate decision taking a wide range of factors into consideration.

Lord Neuberger described as a potentially "dangerous precedent" the idea that HMRC should be given special treatment because of their public duty to collect VAT, and the public interest in the proper collection of tax that was due. He said "if that point were accepted, as it would discourage public bodies from living up to the standards expected of individuals and private bodies in the conduct of litigation. It seems to me that there is at least as strong an argument for saying that the courts should expect higher standards from public bodies than from private bodies or individuals."

Lord Neuberger summed up HMRC's overall case as follows: "Finally, it was said that, bearing in mind all the circumstances, a debarring order was outside the scope of what a reasonable judge in the position of Judge Mosedale could have ordered, even if she made no specific errors. I accept that the decision to make a debarring order against HMRC was tough, and I also accept that some Ft-T judges may not have made that decision. However, the issue whether to make a debarring order on certain facts is very much one for the tribunal making that decision, and an appellate judge should only interfere where the decision is not merely different from that which the appellate judge would have made, but is a decision which the appellate judge considers cannot be justified."

HMRC could not cross the "high hurdle" that this test set. Lord Neuberger noted Judge Mosedale's comments about the difficulties of the "binary choice" before her – to bar HMRC, which was draconian, or to "allow them to get away with it" – and he raised the question of whether the Tribunals rules should offer "more nuanced sanctions". However, he considered that such ideas, while attractive in theory, can often be difficult to formulate or to apply satisfactorily in practice, so he did not recommend pursuing that idea.

HMRC's appeal was unanimously dismissed by all five judges.

Supreme Court: *BPP Holdings Ltd v HMRC*

6.8.4 Late appeals

A golf club sought leave to appeal out of time against a decision dated 26 August 2009 to refuse a claim for overpaid output tax on green fees from 1990 to 2008. The club had received an earlier decision in May and had asked for it to be reviewed, but took no further action following the issue of the review decision confirming the original refusal. The club wrote again in May 2014, together with a new claim for periods from 1 January 2009 to 31 December 2013. No response was received; a reminder was sent in November, and again nothing came back. A further letter was sent in July 2016, referring to HMRC Brief 10/2016 and Information Sheet 01/15. In December 2016, HMRC settled the claim for 06/2010 to 12/2013. Claims for earlier periods were refused as out of time.

The club argued that the information provided with the review decision in August 2009 was not clear. The club had believed that the matter would remain open pending any future court decision. Judge Anne Scott did not agree. She applied the criteria from *Data Select*, and could see no good reason for a very substantial delay. There was no valid reason for believing that the claims remained live. The application for a late appeal was refused, and HMRC's application for strike-out was granted.

First-Tier Tribunal (TC05985): *Kendal Golf Club*

Three social clubs claimed repayments of output tax accounted for on the takings of gaming machines. All were refused. Two clubs (Ashtead and Darfield) appealed to the Tribunal and were then repaid following Rank's success in the High Court. Protective assessments were issued. These two clubs had never appealed against the protective assessments, and now argued that they should be entitled to do so on the basis of the original appeals that they had filed.

The other club (Ashington) appeared not to have pursued its original claim with the same vigour. The initial claim was made by letter on 20 July 2006; HMRC asked for further details on 15 August 2006, but no reply was forthcoming. HMRC then ruled on 8 March 2011 that the claim was not valid because it was not quantified; this view was repeated by another letter on 28 August 2012. The club's representative asked for a review of this decision, which was refused (because the matter arose before 1 April 2009); an application to the Tribunal to make a late appeal was suggested instead. In January 2013, HMRC made a repayment to the club in line with the *Rank* decision, and stated that this money would be demanded back if that was overturned in due course. That demand was issued on 26 February 2015, and the club filed a notice of appeal with the FTT on 8 June 2016.

Ashtead and Darfield applied either to be allowed to appeal the protective assessments late, or to amend the grounds of their original appeals to cover those assessments, as the subject matter was the same. Ashington applied for permission to appeal against the protective assessment late.

The judge (Greg Sinfield) considered the "three-stage approach recommended by the Court of Appeal in *Denton*": "The first stage is to identify and assess the seriousness and significance of the failure to comply with the time limit. If the breach is neither serious nor significant then I do not need to spend much time on the second and third stages. The second stage is to consider the reason for the failure to comply. The third stage is to consider all the circumstances of the case, bearing in mind the overriding objective of the FTT Rules."

The taxpayers' agent had failed to appreciate that Ashington had never had a previous formal rejection of its claim, and had never made an appeal to the Tribunal. This was a mere administrative error. It was understandable, but nevertheless it was not a reasonable excuse for a delay of such length. The judge acknowledged that there would be prejudice to Ashington if the application for a late appeal was refused, but that could not on its own be a reason for allowing it. Taking everything into consideration, he concluded that the application should be refused.

By contrast, the other clubs were in a different position. They had outstanding appeals that had never been withdrawn. The letters notifying the protective assessments had the potential to confuse: although they did contain the warning that there was a need to appeal within 30 days, this could easily be interpreted as a requirement only to notify new grounds of dispute, whereas the clubs had already made their position clear on the matter. The best and fairest way to proceed would be to allow the clubs to amend the grounds of their existing appeals to cover the protective assessments.

HMRC also argued that there was no reasonable prospect of success, and the appeals should be struck out on that ground. The judge did not agree. It was premature to conclude that there was no prospect of success before the exchange of evidence; HMRC had, after all, paid out the claims in the past with interest, at which point they must have considered that there was every prospect of success. There had been no material development since "save that there has been further litigation and is yet more to come". Presumably Rank's defeat in the Court of Appeal is the reason for HMRC enforcing the protective assessments, but they had not sought to rely on that litigation in this Tribunal. The judge therefore dismissed HMRC's application in respect of Ashtead and Darfield.

First-Tier Tribunal (TC06048): *Ashington & Ellington Social Club & Institute Ltd and others*

A trader sought leave to appeal out of time against a November 2012 assessment for £8,704 in respect of his 09/2010 period, denying credit for any input tax. The appeal was made on 23 March, over four years late. The applicant argued that he had not received the assessment until 2017, when Debt Management contacted him; it took some time to establish exactly what it was that HMRC wanted him to pay, whereupon he appealed. He claimed to have supplied the information requested by HMRC twice in 2011, and thought that the matter was settled.

The Tribunal did not accept this version of events. It seemed more likely that the letters had not been sent; for two of them to go astray was improbable. According to the *Data Select* criteria, the application had to be rejected.

First-Tier Tribunal (TC06095): *Abdul Waheed*

6.8.5 Procedure

A company applied for an order barring HMRC from the proceedings. The judge reviewed the history of directions and case management hearings, and concluded that the company was late in making its application. Given that it was attempting to bar HMRC for lateness, that was a fatal flaw, and the application should be dismissed. He said that he would also set out his reasons for dismissing the application anyway, even if it had been on time, although that was not strictly necessary; this was not a comparable situation to *BPP Holdings*, and a barring order would not have been appropriate. The matter will proceed to a substantive hearing in due course, with HMRC fully represented.

First-Tier Tribunal (TC06041): *Award Drinks Ltd (in liquidation)*

There was also a costs hearing in respect of the same dispute. This notes that the appeal concerns assessments for £1.5m and £5m. The judge refused an application for costs from the appellant and awarded costs to HMRC in respect of one of the hearings.

First-Tier Tribunal (TC05962): *Award Drinks Ltd (in liquidation)*

A long running dispute concerned denial of input tax on *Kittel* grounds in relation to 16 transactions claimed to have been undertaken by a car dealer in the periods 09/12 and 10/12. The VAT involved was about £64,000. Dr McNall reviewed the history of the dispute, which had involved numerous case management hearings and directions. The question was whether the trader had complied with those directions, and what to do about it if he had not.

There was some dispute about whether the directions had been drawn to the attention of the taxpayer’s representatives. The judge was satisfied that the Tribunal’s letters containing the directions had reached them, and there was unacceptable delay in responding. The importance of the directions should have been clear, and claims that they were not understood did not seem reasonable.

The appellant had applied to have some of these directions set aside. That application was refused, and the judge made specific directions for the estimated length of the hearing to be agreed by the parties within 14 days, together with dates of unavailability for the substantive hearing over the next 6 months.

First-Tier Tribunal (TC06056): *Alan McCord t/a Hi-Octane Imports*

In TC05445, HMRC applied to have an appeal struck out on the basis that they had not yet made an appealable decision. The appellant argued that a letter sent on 14 January 2016 did contain a decision. The company had in 2010 implemented an arrangement whereby customers from other member states could order mail order goods and arrange for delivery themselves (often using a connected company). The company asked HMRC for confirmation that this would avoid the distance selling rules and UK VAT would be due rather than foreign VAT. HMRC agreed, but suggested that the company should contact the authorities in other jurisdictions to confirm that they were also content with the arrangement (which seems less likely).

In 2015 HMRC wrote to the VAT Committee of the Commission to ask whether it considered that PVD articles 32 to 34 applied where goods were subject to transport arrangements that were linked in this way, for example because the seller of the goods actively promoted, suggested or recommended the transporter to the consumer, even though the transporter provided its services to the consumer rather than the supplier. The VAT Committee issued a discussion paper which concluded, "almost unanimously", that the distance selling rules would be engaged where the supplier "intervenes directly or indirectly in the transport or dispatch of the goods".

On this basis, a specialist in HMRC wrote to the company setting out HMRC's view of the arrangements. It appeared to say that the sales should have been subject to foreign VAT, and the UK VAT would be refunded if the company provided evidence that it had registered abroad and paid the foreign VAT. The company asked for clarification, because it was not sure what HMRC had decided. HMRC responded that it could not rule on the status of the supplies unless the company provided information about its dealings with the authorities in the other member states. The company appealed, and HMRC applied for the appeal to be struck out, on the basis that its "decision letter" did not categorically determine the matter: it was dependent on further information.

The judge commented that there were two unusual features to the appeal: first, that the taxpayer wanted to pay UK VAT; and second, that each party believed that the decision letter was abundantly clear. The judge did not agree that it was, but concluded that the letter did contain a decision to the following effect:

(a) the supplies in question should be regarded as being made in the destination EU member state; and

(b) no refund of UK VAT previously paid would be made until evidence of the VAT paid in each destination member state was provided.

Lengthy reasoning was given for preferring the appellants' interpretation. In particular, the context of the application to the VAT Committee for a ruling suggested that HMRC would follow the Committee's advice. The FTT judge (Tony Beare) refused to strike out the appeal, and suggested that it might be quicker and cheaper for the appeal to proceed and a reference to be made to the CJEU, rather than waiting for confirmation from all the other Member States of how they viewed the transactions.

HMRC appealed to the Upper Tribunal, where the case came before Judge Roger Berner and Judge Timothy Herrington. They rehearsed the law and the history of the dispute, and summarised the FTT decision. They concluded that the FTT had made an error of law in holding that HMRC had issued a decision on the place of supply. The letter did no more than express a conclusion that s.7(5)(a) was engaged, but did not address s.7(5)(c). In terms of the Directive, art.33 applied, but it was subject to the conditions of art.34, about which more information was required. This was not merely part of verifying the validity of the refund claim, as the FTT had concluded, but was a fundamental part of the decision about the place of supply itself.

However, that was not the end of the matter. The decision that s.7(5)(a) was engaged could itself be an appealable decision within s.83, which ought to be broadly interpreted. The taxpayer argued that s.7(5)(a) did not apply, and if the taxpayer was right, there was no further decision to be made about s.7(5)(c) – it would be irrelevant. The decision on s.7(5)(a) gave rise to an issue which had a direct bearing on the chargeability of the taxpayer's sales. If the taxpayer proved to be correct, its sales would be subject to UK VAT in all cases; if HMRC's view was correct, they would be subject to destination country VAT, except where those cases which would meet the art.34 criteria (sales to a member state below the distance selling threshold for that country).

After taking 44 paragraphs to conclude that the FTT had made errors of law, the UT took another 10 paragraphs to dismiss HMRC's appeal. A request by the taxpayer to refer questions to the CJEU was discussed but rejected as premature: it would first be necessary for the FTT to consider the substantive argument, rather than the mere procedural strike-out application that had been argued so far, to decide whether clarification of the law was needed from the CJEU.

Upper Tribunal: *HMRC v SDI (Brook EU) Ltd; Sportsdirect.com Retail Ltd*

6.8.6 Costs

HMRC raised an assessment into a taxi firm's VAT position in February 2014. On review in June 2015, it was varied to just under £1.4m. The business filed an appeal on 9 July 2015, alongside an application to enter ADR, which proved unsuccessful. HMRC withdrew its defence to the appeal on 14 December 2016. The taxpayer applied for costs.

Judge Abigail McGregor noted that the only question for her to determine was whether HMRC acted unreasonably in bringing, defending or conducting the proceedings in question. Attempts by the taxpayer's representative to make the issues more complicated, based on the case of *Catana*, did not succeed.

The *Tarafdar* case suggested there were three questions to ask:

- What was the reason for the withdrawal?
- Could the withdrawing party have withdrawn at an earlier stage in proceedings?
- Was it unreasonable for the withdrawing party not to have withdrawn at an earlier stage?

In spite of attempts by HMRC's representative to interpret the withdrawal letters differently, the judge was satisfied that HMRC had withdrawn because they had appreciated that the result of winning would be cash-neutral for them: the business would be able to charge on any VAT to local authorities, which would recover it under s.33. This was a point that they could have appreciated earlier if they had taken legal advice; it had been put forward in the ADR process, but apparently not understood. The judge decided that the withdrawal could have been made as early as the time of filing the appeal notice, and exercised her discretion to award costs from that date.

That made it unnecessary to consider whether the conduct of the ADR process had also been unreasonable, because its costs would be part of the overall award. However, she noted that HMRC had sent "the wrong officers" to the ADR meeting – they had no knowledge of the matter and could not make any agreement other than that set out in the HMRC decision on review that was under appeal. Afterwards, an exit agreement was signed in which HMRC committed to send submissions to its policy team, after having sent the draft submission to Sussex Cars' representative "for her comments". The draft submission was sent to Sussex Cars' representative, who made comments on it. When the submission was made to the HMRC policy unit, it included none of Sussex Cars' comments, rather attaching the opening statement that had been exchanged in advance of the ADR meeting.

HMRC submitted that sending the wrong officers to the ADR meeting had no detrimental effect on Sussex Cars and that the submission to policy afterwards meant that any issues raised during the ADR process were fully considered by HMRC. The fact that the outcome of that process was "no movement on HMRC's side" did not mean that the process was futile. Judge McGregor agreed with the taxpayer that this represented a failure to engage in the ADR process at all, while putting the taxpayer to the cost and effort of engaging in it. This was also unreasonable conduct.

The judge directed that the costs should be assessed in detail on the standard basis by a costs judge of the Senior Courts.

First-Tier Tribunal (TC06110): *Sussex Cars Association*

6.8.7 Information Notice

HMRC issued an Information Notice on 10 November 2016 under FA 2008 Sch.36. The company appealed on 14 February 2017, arguing that the Notice was incorrectly issued and should be withdrawn. The law on such Notices provides that there is no right of appeal if HMRC demand production of "statutory records", which has been considered in two Tribunal decisions (*Concrete Flooring Ltd* and *Drinks Stop Cash and Carry*).

The Information Notice served on the Appellant on 10 November 2016 set out the information to be provided as:

"*Please provide the statutory records for 01/02/2012 to 30/04/2016 as follows:*

The VAT account and any related working papers

Sales and purchase daybooks

Cash books

Petty Cash books

Sales and purchase invoices, this includes Purchase invoices that were missing from your records in the VAT period ended 30/04/16 in relation to Butcombe and Otter Brewery.

Bank and Building Society statements for period 01/01/2013 – 30/04/2016 for all accounts through which business funds are transacted, where so ever in the world these are held.

Other documents or information that we need

[In this context document means...........]

Annual accounts for the year ended 30/04/2014 and 30/04/2015 including the profit and loss account and balance sheet.

A drinks price list (including wine) relevant to the VAT period ended 30/04/16."

The appeal was both against (i) the Information Notice on the basis that the information requested was not reasonably required by HMRC and (ii) the specific requirements of the Information Notice to provide the drinks price list. Both parties agreed that the drinks price list was not statutory information.

The Tribunal reviewed the history of the HMRC enquiry into the public house run by the company. A variety of information had been requested for production at a visit in July 2016. At the visit, shortcomings in the VAT accounting were discovered, and the officer wanted the price list to carry out a credibility check on sales. An Information Notice was issued on 21 July but later withdrawn because the schedule of required information had not been attached; the November Notice was a replacement for this earlier botched request.

The appellant protested that HMRC had acted in an aggressive and bullying fashion throughout, demanding information rather than allowing the appellant to provide it voluntarily, and insisting on further visits to the premises at inconvenient times. The technical failings in the Notice included the dates: it asked for information going back to 01.02.2012, when an assessment could not go back that far if raised in November 2016. There had also been a control visit that covered all periods up to 30 April 2012, which should therefore be regarded as closed. HMRC responded that FA 2008 gives them the right to require production of records for up to six years, even if they can only assess for four. The information might still be relevant to consideration of more recent periods. No closure notice had been issued for 04/2012.

The judge (Rachel Short) agreed with the appellant on the timing point. The law provided for HMRC to request information that is "reasonably required to check the taxpayer's tax position". If HMRC could only assess four years, a request information to "check the taxpayer's tax position" for more than that four year period required them to have a specific reason why information was needed for those earlier periods. In this instance no such specific explanation was given; HMRC's response was merely that "they usually asked for six years worth of information".

The judge noted that there might be a difficulty in that there is no right of appeal against a request for statutory information. In her view, the overall "reasonableness" of the requirement for the information came first; if the Notice itself was unreasonable, that was a fundamental flaw that ought to result in the cancellation of the Notice as a whole. It made no difference that the unreasonable Notice required the production of statutory records.

The Tribunal quashed the Notice, but also commented that if (or, more probably, when) HMRC issue a replacement:

- the price list was non-statutory but would be reasonably required;
- the annual accounts, which the Notice had treated as non-statutory, should be classified as statutory on the strength of the Tribunal case precedents.

First-Tier Tribunal (TC06116): *The Barty Party Company Ltd*

6.9 Other administration issues

6.9.1 Making tax digital

On 13 July, the government finally recognised the enormous risks involved in imposing the new digital tax system on a wide range of businesses for income tax from April 2018 without more widespread testing. Accordingly, MTD will not apply to income tax until 2020 at the earliest, and is then likely to be optional for businesses below the VAT registration threshold.

However, MTD will be introduced from April 2019 for VAT, and will be mandatory for all VAT-registered businesses. Although traders may believe that this is not a big change, because they already make online quarterly submissions for VAT, the significance should not be underestimated. The MTD rules require the maintenance of underlying digital records; it will not be acceptable to keep transaction records on paper and only input the totals into the VAT return as at present. The precise format of the required software, and the detail that will be reported to HMRC, has still to be determined.

The system will be subject to small scale, private testing from the end of 2017, and more widespread public trials from Spring 2018.

www.gov.uk/government/news/next-steps-on-the-finance-bill-and-making-tax-digital

HMRC have published an overview of the primary legislation on making tax digital for VAT, contained in the Finance Bill 2017-19 introduced on 8 September. The document also outlines the main requirements to be set out in VAT regulations which the government intends to introduce no later than April 2018. HMRC invite comments on this document by 10 November 2017.

From April 2019, businesses with a turnover above the VAT threshold (currently £85,000) will have to:

- keep their records digitally (for VAT purposes only), and
- provide their VAT return information to HMRC through Making Tax Digital (MTD) functional compatible software.

Clause 62 retains what is currently in place in Sch.11 VATA 1994 with regards to keeping and preserving records, the keeping of accounts, and the making of returns. But it introduces new powers to make regulations about the submission of information from VAT registered businesses. In addition, for those businesses with turnover above the VAT registration threshold, the clause introduces new powers allowing the commissioners of HMRC to make regulations that require a business to keep and preserve certain records digitally.

Specifically, Clause 62:

a) Gives the Commissioners of HMRC powers to make regulations requiring the submission of information relating to VAT (VAT Act 1994, Schedule 11 Paragraph 2).

b) Gives the Commissioners of HMRC powers to make regulations that specify the form in which records are kept and preserved (VAT Act 1994, Schedule 11 Paragraph 6 and 6A).

c) Where regulations are made that require records to be kept and preserved digitally, gives the Commissioners of HMRC the powers to specify how digital records are kept and the conditions that must be complied with.

d) Where these powers are used to require records to be kept and preserved in a digital format, provides an exemption for businesses with a turnover below the VAT registration threshold.

e) Ensures that, once a business is required to keep digital records, this requirement remains in place even if that businesses turnover falls below the threshold and that person remains registered for VAT.

f) Gives the Commissioners of HMRC the power to vary the exemption provisions, in the case of transfers of a going concern, and add further exemptions in the future.

g) Gives a right of appeal against HMRC decisions about the application of regulations relating to VAT requiring the use of digital communications or digital record-keeping.

h) Ensures that regulations providing for digital record keeping can’t come into force before 1 April 2019.

There will be exemptions for those who are unable or unwilling for religious reasons to use electronic systems, mirroring the present rules for filing.

The key points about records are contained in an outline of the regulations that will be issued in due course:

Functional compatible software means a software program or set of compatible software programs which can connect to HMRC systems via an Application Programming Interface (API). The functions of the compatible software must include:

- keeping records in a digital form as required by the regulations;
- preserving digital records in a digital form as required by the regulations;
- creating a VAT return from the digital records held in functional compatible software and providing HMRC with this information digitally;
- providing HMRC with VAT data on a voluntary basis;

- receiving information from HMRC via the API platform in relation to a relevant entity's compliance with obligations under the regulations.

The regulations and HMRC notices or directions issued under them will specify details of the business's obligations to keep and preserve VAT records digitally. Businesses will need to preserve digital records in functional compatible software, for up to 6 years.

Following deregistration, a business must preserve their records for up to 6 years. For businesses in scope for MTD, those records that relate to the period between mandation and deregistration must be preserved digitally for up to 6 years.

The regulations will specify the information a business needs to keep and preserve digitally, and will include:

- business name, principle place of business and VAT registration number - this 'designatory data' will also include information about which VAT accounting schemes they use;
- the VAT account that each VAT registered business must keep, by law – the VAT account is the link – the audit trail – between primary records and the VAT return;
- information about supplies made and received.

There will be specific rules for users of special arrangements such as retail schemes or the flat rate scheme.

The information contained with the VAT return will be generated by pulling information from the digital records. This information will contain as a minimum the 9 boxes required for the VAT return, but can also contain a specific data set of supplementary information – all of which will be pulled from the digital records.

In the MTD consultation response published on 31 January 2017 HMRC envisaged that the deadline for submissions of information for Income Tax and VAT would be aligned. For the time being, however, there will be no change to statutory VAT return or payment dates. HMRC will reconsider the position if and when MTD for Income Tax becomes mandatory.

Businesses submitting monthly returns (whether directed to by HMRC or doing so voluntarily), will continue to do so. Similarly businesses submitting non standard returns can continue to do so.

The VAT annual accounting scheme will be retained with the current conditions. All of the above, if not exempt from MTD, will be required to keep digital records and submit their VAT returns through functional compatible software.

Businesses will be able to submit VAT information more frequently than their VAT return obligations require. The regulations will provide for the submission of this information on a voluntary basis ('voluntary update').

There is an interesting section on "supplementary data":

HMRC believes that businesses and HMRC could benefit from the submission of supplementary data. While the simplicity of the '9 Box' VAT return has advantages for businesses in terms of reduced administrative burdens, because HMRC receives no information about *how the figures in the return are arrived at, it is difficult for HMRC to target its 'downstream' compliance activity at customers most likely to be non-compliant.*

HMRC will permit, and functional compatible software will provide for, the voluntary submission of supplementary VAT data as part of a VAT return or a voluntary update.

The legislation will describe the information that would be required but, broadly, this will be summary totals of the information required to be kept and preserved electronically as detailed in Annex 1.

The existing error correction rules will apply where a taxable person needs to amend their VAT accounting records.

Corrections to previously submitted VAT Return updates will continue to be made through the current processes (SI 1995/2568 Reg 34, 35, VAT Notice 700/45). Non-deliberate errors that are below the reporting threshold can be adjusted on the next VAT Return, using functional compatible software, as long as they are within the 4 year limit. Other errors will need to be reported through the VAT652 (Notification of errors in VAT returns) procedure, but HMRC is considering options for provision of non-mandatory electronic channels for submission of form VAT652, including the potential for provision via functional compatible software.

Where a taxable person needs to amend an update that is not accompanied by the legal declaration required for the VAT return, they can do so by simply supplying the corrected or updated information to HMRC using their MTD functional compatible. Similarly, if a taxable person needs to amend supplementary VAT data provided voluntarily, they can do so by supplying the corrected or updated information through the MTD functional compatible. These changes won't be subject to behavioural penalties.

The contents of the digital records will be defined by regulations:

Designatory data:

- business name
- principal place of business
- VAT registration number
- VAT accounting scheme use indicators (more than one scheme may be used for example flat rate scheme, cash accounting, retail schemes, margin schemes, partial exemption and gold special accounting scheme)

VAT account

VAT payable portion:

- total output tax due for the VAT return period
- total output tax on acquisitions from other EU member states
- total output tax on supplies received where the business is required to account for and pay on behalf of the supplier (reverse charge output tax)

VAT allowable portion:

- total input tax allowable for the VAT return period
- total input tax allowable on acquisitions from other EU member states

Adjustments:

- corrections of an error in calculating VAT payable in previous periods (SI 1995/2568 Reg 34, 35).
- adjustments to VAT payable because of an increase or decrease in consideration of a supply made in a previous period (SI 1995/2568 Reg 38)
- any other adjustments required by VAT rules. Types of adjustment include:
- change of rate credit notes (SI 1995/2568 Reg 15)
- adjustments for use of an approved estimation procedure (SI 1995/2568 Reg 28, 29(3))
- retail scheme annual adjustments (SI 1995/2568 Reg 66-75)
- partial exemption annual adjustments (SI 1995/2568 Reg 107-107F)
- change of use input tax adjustments (SI 1995/2568 Reg 108,109)
- capital goods scheme adjustments for subsequent intervals (SI 1995/2568 Reg 112-116)
- bad debt relief claims (SI 1995/2568 Reg 165-172) and associated input tax repayment where consideration not paid (SI 1995/2568 Reg 172F-172J)

Only the total for each type of adjustment will be required to be kept digitally not details of the calculations underlying them.

Other Information

Further information required in addition to the VAT account

- Outputs value for the period split between standard rate, reduced rate, zero rate, exempt and outside the scope outputs.
- Inputs value for the period split between standard rate, reduced rate, zero rate, exempt and outside the scope inputs.

Data for supplies made and received:

- VAT accounting date for the transactions on the invoice:
- for traders on cash accounting scheme (or on the cash turnover method within the VAT flat rate scheme), the date of receipt or payment
- for other traders, the time of supply for VAT purposes (or, for input tax only, the date of receipt of the VAT invoice or alternative evidence if later), this will often, but not always be the date of invoice
- the invoice total broken down into sub-totals for each rate of VAT chargeable

- the VAT charged at each rate on the invoice

Where an invoice covers several supplies, line by line input of each supply will not be mandatory, provided the VAT accounting date is the same for all of them.

Data for supplies made and received - for retailers

The changes introduced under MTD will require businesses to keep a minimum data set electronically. Retailers will be permitted to record electronically sales transaction data based on daily gross takings, rather than recording details of each sale where they account for VAT using a retail scheme.

VAT account

If the retailer is on a VAT Retail Scheme, the VAT payable portion of the VAT account should include the standard-rate and reduced-rate VAT due on gross takings for the VAT return period, as calculated by the Retail Scheme.

Supply data

Where retailers can't reasonably record each individual retail sale, the supply data requirements above for such sales will be replace by records of daily gross takings for such sales, including:

- cash payments received for retail supplies
- the full value of non-cash (credit) retail sales at the time of supply
- details of any adjustments made to daily gross takings

www.gov.uk/government/consultations/making-tax-digital-reforms-affecting-businesses

6.9.2 Private Members' Bills

Christopher Chope MP has put forward two private members' bills: Domestic Energy (Value Added Tax) Bill and Value Added Tax Bill. The purpose of the proposals is said to be "to reduce Value Added Tax on domestic energy bills; and for connected purposes" and "to enable the maximum turnover threshold for exemption from the requirement to register for VAT to be raised; to make provision for the exemption of certain goods and services from liability to VAT; and for connected purposes".

It seems unlikely that either measure will become law, not least because the Chancellor tends to regard tinkering with tax provisions to be his own prerogative.

6.9.3 Finance Bill 2017-19

The material dropped from the first FA 2017 because of the election was republished (with additions) on 8 September. It is 665 pages long. The main points relating to VAT are:

- cl.48 – 59 and Sch.13: provisions relating to fulfilment businesses;
- cl.62: MTD rules for VAT;

- cl.66 and Sch.17: changes to disclosure of VAT avoidance scheme rules;
- cl.68: penalty for transactions connected with VAT fraud.

The unusual name of the Bill refers to the fact that it is the first Finance Bill of the 2017/19 extended Parliamentary session.

https://publications.parliament.uk/pa/bills/cbill/2017-2019/0102/cbill_2017-20190102_en_1.htm

6.9.4 Extra-statutory concessions

HMRC have issued an updated version of their Notice covering VAT and indirect taxes concessions. The following VAT concessions became obsolete in April 2017:

3.20 – replaced by SI 2017/495 (relating to repayment of input tax on bad debts where an insolvency procedure has intervened)

3.23 – withdrawn with effect from 1 April 2017 (supplies by Financial Ombudsman Services Ltd to ombudsman authorities)

3.28 – withdrawn with effect from 1 April 2017 (supplies by Financial Services Authority to self-regulating organisations)

3.31 – withdrawn with effect from 1 April 2017 (supplies by the Financial Services Compensation Scheme Ltd to compensation scheme authorities)

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6.9.5 National Audit Office report on HMRC

The NAO has issued its annual report on HMRC's accounts for the year 2016/17. The report considers in some detail four areas:

- tax revenues and spending (noting an increase in VAT collected of £8.4 billion, or 7.2%);
- tax credits and Child Benefit error and fraud;
- "transformation" – 15 ongoing projects intended to increase efficiency and collect more tax while moving to a wholly digital system by 2020;
- customer service performance, where HMRC have reduced waiting times for people hanging on the telephone from 12 minutes to 4 minutes.

www.nao.org.uk/press-release/her-majestys-revenue-customs-annual-report-and-accounts-2016-17

6.9.6 The VAT guide

HMRC have published a new version of Notice 700. The "what's changed" section lists an unusually large number of amendments, most of which appear to be clarification and reorganisation rather than anything more technical.

Notice 700

6.9.7 Articles

In an article in *Taxation*, Neil Warren discusses the importance of finding out facts from the client, keeping an open mind and not allowing the client's misguided interpretations of the situation to prejudice the adviser's view of the correct VAT treatment. He comments in particular on situations involving joint owners of land and options to tax, and the relevance of the intended use of a building for the liability of construction services.

Taxation, 27 July 2017

In an article in *Taxation*, Adam Craggs and Constantine Christofi discuss the work of HMRC's criminal investigation unit. They point out that from September 2017, HMRC will begin to receive large quantities of data from the 51 'early adopters' of the common reporting standard, which will increase dramatically the information available to HMRC. Data from the major banking centres of Switzerland, Dubai, Hong Kong and Singapore will come on stream in September 2018.

Taxation, 27 July 2017

6.9.8 Consultation on large business risk review

HMRC are consulting until 6 December 2017 on improving their approach to risk profiling large businesses, which has remained largely unchanged since its introduction 10 years ago. The consultation considers changes such as increasing the number of risk categories to cover low risk, low-moderate risk, high-moderate risk, high risk and significant risk, and introducing a code of practice for the highest-risk businesses. The government announced its intention at Spring Budget 2017 to consult on the review.

Most businesses with a turnover of more than £200m are managed by HMRC's Large Business (LB) directorate. Additionally, the LB directorate also manages businesses whose revenue is below £200m if they are particularly complex (e.g. very large multinational enterprises with a small UK footprint) or to maintain consistency of approach across a complex sector.

www.gov.uk/government/consultations/consultation-on-the-business-risk-review

6.9.9 Criminal sentence

An accountant who helped her employer undertake a £40m VAT and excise duty fraud (relating to underdeclaring wines brought to the UK from Italy) has been sentenced to three and a half years in jail. The company director was sentenced to 14 years, but he has absconded and is the subject of a European arrest warrant.

Crown Prosecution Service 17 July 2017