VAT UPDATE
APRIL 2022

Covering material from January – March 2022

Notes prepared by Mike Thexton MA FCA CTA (Fellow)

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1. INTRODUCTION

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

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

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

1.1 Appeals pending

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

The latest update to the HMRC website appeared on 22 February 2022.

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

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

- *Beigebell Ltd*: HMRC succeeded in appeal (covered in July 2020 update) against the FTT decision that a company's directors did not have the means of knowledge of the connection of their company's transactions to a missing trader fraud: case remitted to a differently constituted FTT.
- *Chelmsford City Council, Mid-Ulster District Council*: HMRC have been granted leave to appeal on particular points against the FTT's decisions on local authority sports provision (no appeal against the related decision in *Midlothian Council*). UT hearing listed for March 2022.
- *DCM (Optical Holdings) Ltd*: the taxpayer has been granted leave to appeal against the Court of Session's decisions in favour of HMRC (hearing 8 February 2022).
- *Gray & Farrar International Ltd*: HMRC have applied direct to the CA for leave to appeal against the UT decision in the company's favour on place of supply (the UT refused leave).
- *Hotel La Tour Ltd*: HMRC are seeking permission to appeal the FTT decision in the company's favour on the deductibility of the incidental costs of selling a subsidiary.

- *Netbusters (UK) Ltd*: HMRC have been granted leave to appeal to the UT against the FTT decision that the company's provision of sporting facilities was exempt (hearing listed for May 2022).
- *News Corp UK & Ireland Ltd*: the company is seeking leave to appeal to the Supreme Court against the CA's decision that its digital newspapers did not qualify for zero-rating before the law was changed on 1 May 2020.
- *NHS Lothian Health Board v HMRC*: Court of Session allowed taxpayer's appeal on grounds that "no repayment" had to be the wrong answer; remitted to FTT for reconsideration of the amount; HMRC have been granted leave to appeal to the Supreme Court.
- *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 (not on HMRC's list).
- *Revive Corporation Ltd*: MTIC case remitted by the UT to the FTT for rehearing.
- *The Prudential Assurance Company Ltd*: FTT decision in company's favour in the July 2021 update. HMRC are seeking permission to appeal to the UT.
- *Thorsteinn Gardarsson t/a Action Day A Islandi*: HMRC succeeded in their appeal against the FTT decision that a trader's products qualified as "books" rather than "stationery", and some issues have been remitted to a differently constituted FTT for further consideration (no longer on HMRC's list).

1.1.1 Decisions in this update

Although there are many decisions in this update, none of them have previously been listed on HMRC's website as outstanding.

2. OUTPUTS

2.1 Scope of VAT: linking supplies to consideration

2.1.1 Parking penalties

The *Apcoa ParkingDanmark* case echoes the several UK cases of *Vehicle Control Services Ltd* (last in CA 2013) on the liability of charges for failing to comply with parking rules. The appellant is a private company that operates parking lots on private land in agreement with their owners. The agreement sets the conditions for the use of parking spaces, such as the prohibition of parking without specific authorisation, the maximum parking time and the possible payment of a fee in return for this. In the event of violation of the conditions of use, the company collects in addition a specific control fee. VAT is charged on fees for use in compliance with the terms and conditions of the parking lot; the dispute concerned whether the control fees were also subject to VAT, or were outside the scope as compensation for a breach of contract.

The control fee could be charged in the following circumstances:

1. Payment of an insufficient fee.

2. Valid parking ticket not visible on the windscreen.

3. Uncontrollable ticket, for example, if the parking ticket is incorrectly placed.

Cases 1 to 3 apply in the event of paid parking.

4. Lack of valid parking ticket, for example, in the context of residential parking for which permission to use specific parking spaces is required.

5. Parking in a place reserved for disabled people. This reason for charges only applies in the presence of a disabled parking sign, whether the parking is free or paid. To be able to park in these locations, the driver must have placed a documentary evidence on his windshield.

6. Parking outside designated parking spaces. This charge pattern applies to all types of parking spaces when a sign indicates to park inside the spaces.

7. Parking prohibited. This charge ground applies, for example, in the event of parking on a fire defense lane.

8. Reserved parking area. This charge pattern applies to all types of parking spaces for which parking in the specific spaces is required.

9. No visible parking disc.

10. Parking disc incorrectly set / indicated parking time exceeded.

11. Illegible parking disc. This charge pattern applies, for example, when the needles have come loose from the parking disc or if there is an error in an electronic disc.

12. Multiple parking discs. This reason for charges applies in cases where the motorist has placed several parking discs on the windshield in order to extend the parking time.

Fee grounds 9 through 12 apply in cases where parking is free for a limited time, but a parking disc is required as proof of when the car was parked.

13. Other. This reason for charges applies in the event of violation of the parking rules which are not described in any of the 12 points above. Point 13 applies, for example, when parking clearly obstructs traffic. If this reason for costs is used to justify the collection of control costs, it will be supplemented by a text describing the infringement.

The company argued that there was no "reciprocal performance" in respect of the control fees, as in the *Tolsma* case. The dispute went through the Danish courts in the context of a repayment claim for output tax accounted for between 1 September 2008 and 31 December 2009, amounting to some €3.4 million.

The question referred very simply asked whether the charges constituted consideration for a service and were therefore within the scope of VAT.

The A-G analysed the issues as:

- Is there a service?
- Does the amount due constitute effective consideration?
- Is there a direct link between these two elements?

The first question involved the distinction between the precedent cases of *Eugenie-les-Bains* (forfeited hotel deposits, outside the scope) and *MEO* and *Vodafone Portugal* (termination charges for phone contracts, chargeable). The Commission supported the taxpayer, but the A-G agreed with the Danish government. In his view, the control charges were part of the consideration for the overall service of providing customers with the possibility of parking their vehicles. The A-G suggested that the *Eugenie* judgment would only apply if there was no performance: in this case, the customer had parked a vehicle, and a service had therefore been provided.

Turning to the second point, the company argued that the charges were so much in excess of any benefit to the motorist that they could not properly be regarded as consideration for a service. The A-G recalled that the amount of consideration is not a relevant criterion. There was a correlation between charging for irregular use and the costs of operating the car parks – customers who infringed the rules caused inconvenience and extra work, and the possibility of a charge was the economic return for this.

The direct link, according to precedent, existed where "two services are mutually conditional, the remuneration received by the service provider constituting the actual equivalent value of the service provided to the beneficiary, namely that one is performed only on condition that the other is also performed, and vice versa". That was the case here, as the charge was levied in the circumstances determined and advertised by the appellant company.

The A-G also opined that the tax charge could not depend on whether the customer complied with the rules or not. That would infringe the principle of fiscal neutrality: the charge related to parking, and was therefore taxable.

The A-G recommended that the court reply that the charges were within the scope of VAT.

The full court noted among the arguments of the Ministry of Taxation:

- the effective result of paying the control fee was the provision of a parking space, and there was therefore a direct link between the payment and the service;
- the control fees collected were a significant proportion (approximately 34%) of Apcoa's turnover;
- the traditional approach in Denmark, supported by domestic case law dating from 1996, was that control fees were treated as "increased parking fees" and were subject to VAT.

The doubts of the referring court were raised partly by the fact that some other Member States (e.g. Sweden and Germany) do not levy VAT on parking charges of this sort. The European Commission made representations supporting the company's position.

The court distinguished *Eugenie-les-Bains* on the grounds that the payments in that case related to a service that had not been, and was never, supplied; in the present case, there was parking before there was a control fee. There was therefore a link between the control fee and the service supplied. The court agreed with the A-G that the payment was part of the whole agreement between the motorist and the company, and was therefore taxable; it was also related to the cost of providing the service, because the company had to build the costs of enforcement into its pricing structure. The commercial and economic reality of the situation was that it was part of the company's turnover in the same way that the parking fees were.

The court rejected the company's argument that there was no relationship between the predetermined penalty charge and the value of the service provided. That was irrelevant in determining liability to VAT. Similarly, the domestic Danish categorisation of the charge as a "penalty" could not affect the application of the EU-wide concept of "consideration for a supply".

The answer given was: "[Art.2(10(c) PVD] must be interpreted as meaning that the control fees levied by a company incorporated under private law, tasked with the operation of private car parks, in the event of failure by the motorists to comply with the general terms and conditions for use of those car parks must be regarded as consideration for a supply of services within the meaning of that provision and, as such, subject to VAT."

CJEU (Case C-90/20): *Apcoa ParkingDanmark A/S v Skatteministeriet*

2.1.2 Early termination fees and compensation payments

HMRC have replaced Revenue & Customs Brief 12/2020, which introduced a revised policy on early termination payments and compensation payments but proved controversial. HMRC suspended the operation of the policy in January 2021 while they carried out a review, but the new policy will now be applied from 1 April 2022.

As before, the reason for the change in policy is HMRC's response to the CJEU decisions in *Meo* (Case C-295/17) and *Vodafone Portugal* (Case C-43/19). HMRC have concluded from these cases that "Most early termination fees and some cancellation fees are therefore liable for VAT if the goods or services for which the fees have been paid are liable for VAT, even if they are described as compensation or damages."

As before, the Brief cross-refers to sections in the HMRC Manuals where the new guidance is set out in relation to particular situations. The Brief itself is very brief:

HMRC policy on early termination fees and similar payments is changing from 1 April 2022. Our guidance manuals on charges described as compensation or early termination fees, are being changed to make it clear when HMRC considers they are payments for a supply and potentially liable for VAT.

The main impact of the revised policy is that fees charged when customers terminate a contract early will be regarded as further consideration for the contracted supply. For example, if a customer is charged a fee for exiting a mobile phone contract early, or if they terminate a car hire contract early, it will be liable for VAT.

This does not affect the tax treatment of full or part payments made on account for a taxable supply, which is explained in Revenue and Customs Brief 13/18.

Businesses making supplies subject to the Tour Operators' Margin Scheme, can find out more information in the Revenue and Customs Brief 09/19.

The new guidance can be found at VATSC05910, VATSC05920 and VATSC05930.

The guidance VATSC06710, 06720 and 06730 has been withdrawn. The suspended September 2021 version of guidance VATSC05910, VATSC05920 and VATSC05930 is also withdrawn.

The crucial difference between this Brief and the 12/2020 version is the date from which it is supposed to take effect:

All businesses must adopt the revised treatment no later than 1 April 2022. This includes any taxable person that has had a specific ruling from HMRC saying that such fees are outside the scope of VAT.

Businesses that adopted the revised treatment for payments that are further consideration for supplies should continue to treat these supplies in accordance with the revised policy.

Any business that adopted the treatment outlined in the guidance published in September 2020 and accounted for VAT on transactions which under the latest guidance are outside the scope of VAT may correct this in the normal way — see the guidance on error correction.

R&C Brief 12/2020 required the change to be applied retrospectively by error correction.

The areas covered by the new guidance are:

- VATSC05910 – Consideration: Compensation and liquidated damages that are consideration: When are compensation payments consideration for a supply?
- VATSC05920 – Consideration: Compensation and liquidated damages that are consideration: Compensation payments: Early termination of contracts
- VATSC05930 – Consideration: Compensation and liquidated damages that are consideration: Liquidated damages

The most controversial change in the previous version related to dilapidation payments. The guidance now says:

Another potentially difficult area are dilapidation payments which occur in the land and property sector. These vary in the way they are provided for but broadly they exist to ensure landlords are not out of pocket if buildings are not returned in the agreed condition at the end of a lease. Our policy continues to be that these are normally outside the scope of VAT, see VAT Notice 742 Land and Property.

Again, the question that needs to be addressed is whether the payment is sufficiently linked to the supply of the lease to be regarded as further consideration for it. The service being supplied is the grant of an interest in the premises by way of a lease. It is the lease which creates the obligation to make such dilapidation payments. The obligation to make a dilapidation payment is not inevitable, rather the lease creates an obligation to return the property in the agreed state and it is the default on this obligation that gives rise to the requirement to make a dilapidation payment.

The tenant takes on a package of rights and obligations when entering the lease, one of which is to return the building in the agreed state. The rent will normally reflect those rights and obligations. If the tenant does not fulfil its obligation to return the building in the required state, it is required to make a further payment so the landlord can restore the building to the agreed condition, and it is in effect a re-imbursement of the cost of goods and services that the landlord faces incurring. It is arguable that this therefore represents additional consideration for the supply of the lease. If the obligation to return the building in the agreed state was not there it is probable that the rent would be set higher to allow the landlord to cover the costs of rectifying the building at the end of the contract.

On the other hand, if the tenant had exceeded the wear and tear that might reasonably be expected during the period of the lease, or even undertaken unapproved alterations, the dilapidation payment would be to rectify damage rather than for use of the premises and would be beyond what the landlord agreed the tenant could use the premises for. The link between payment and supply would therefore be broken. Although the payment arguably covers the landlord's expenses in meeting the tenant's obligation under the lease it may be difficult to establish that the rent has been set with that in mind. It may be that the rent in reality reflects what the market will bear and would not be increased if the dilapidation clauses were removed from the lease. In that case the dilapidation payment would be made to put right damage and there would not be sufficient link between the payment and the service(s) the landlord had

agreed to provide under the lease. It would not therefore be further consideration for the lease.

Our policy having weighed these factors is not to treat dilapidation payments as further consideration for the supply of a lease. We might depart from that view if in individual cases we found evidence of value shifting from rent to dilapidation payment to avoid accounting for VAT.

The guidance also refers to parking charges: *HMRC's policy position is that where a fine is substantial and punitive and is designed to deter a breach of the terms and conditions of parking it will be outside the scope of VAT as the reciprocity needed to link it to the supply is lacking. If on the other hand it is effectively an additional charge for occupying a space, then it would be a standard rated supply. The level of the fee for breaching the parking terms in comparison to the standard parking fee may be indicative of which category a particular fine would be in.*

Revenue & Customs Brief 2/2022; *VATSC05910*, *VATSC05920*, *VATSC05930*

2.1.3 Article

In an article in *Taxation*, Elizabeth Small discusses the above Brief and its development from the earlier versions. She notes and expands on six "lessons":

- there is a presumption that a business that makes taxable supplies to a taxpayer will be liable to output tax on any further payments made by the customer;
- it is important to understand contracts, to assess what is permitted or envisaged and what is not;
- dilapidations are once again normally outside the scope of VAT;
- consumption is not always the key test – the availability of the service may constitute a supply, and a payment to get out of a contract may be VATable;
- penalties that are penal and intended to deter are likely to be outside the scope (although she suggests HMRC's view is not consistent with the *Apcoa* decision);
- the drafting of legal documents, board minutes and business plans may affect the judgement call in deciding whether there is a link between payments and supplies.

Taxation, 17 March 2022

2.2 Disbursements

Nothing to report.

2.3 Exemptions

2.3.1 Private tuition

A trader registered for VAT as a sole trader on 1 July 2006. She provided dog grooming services and courses in dog grooming. In December 2017 she applied to deregister on the basis that the courses were exempt as private tuition, and the taxable grooming services fell below the threshold. After a visit and some correspondence, HMRC agreed to deregister the trader on 4 September 2018. On 11 October 2018, the trader issued an error correction notice claiming a repayment of £102,301 in output tax wrongly accounted for on exempt supplies.

On 31 July 2019, HMRC wrote to the trader stating that the earlier decision had been wrong: dog grooming courses were not exempt, so the registration would be reinstated, the error correction would be refused, and VAT should be accounted for in respect of supplies made in the intervening period. The trader appealed.

Judge David Bedenham reviewed the case law on this issue, and set out the issues that had to be decided. The evidence supported the trader's contentions that she supplied skills and knowledge rather than something purely recreational, and that she provided all the teaching herself – any indication to the contrary on her website was to give the impression of a more substantial business.

The key question was whether the trader had discharged the burden of establishing that the teaching of dog grooming was "commonly or ordinarily provided in schools or universities". The trader's representative had given evidence concerning research that showed that 88 Further Education Colleges in England offered courses that had a dog grooming element, and 57 of them offered a freestanding course that led to a qualification of some sort. The judge stated: "However, that is not the test. The test is whether dog grooming is ordinarily taught in a school or university which, in agreement with the Tribunal in *Premier Family Martial Arts*, we take to mean that the relevant activity must be taught at a wide number of schools or universities in the EU. We were provided with no evidence that dog grooming is taught in the United Kingdom anywhere other than certain Further Education Colleges in England, and we were provided with no evidence at all about the position in other member states. In those circumstances, we are not satisfied that the Appellant has met the burden of proving that dog grooming is taught in a wide number of schools or universities in the EU. We would not have expected the Appellant to conduct exhaustive searches of every school and university in every member state but we consider that some evidence of the position in other member states (and other parts of the UK) is necessary."

The appellant also contended that another similar business had been treated as exempt by HMRC; however, no evidence had been presented to show that the other business operated in the same way, so there was insufficient basis for a finding that HMRC's actions breached the principle of fiscal neutrality.

The Tribunal recognised that HMRC's shift in position, first allowing deregistration and then reversing that decision, might appear unfair; however, the Tribunal had no general jurisdiction over the fairness of HMRC's actions. The appeal was dismissed.

First-Tier Tribunal (TC08380): *Julie Lalou T/A Dogs Delight*

2.3.2 Article

In an article in *Taxation*, Neil Warren examines the problems arising from interpreting the exemption for private tuition, with particular reference to the above case.

Taxation, 3 March 2022

2.3.3 Thermal treatment

A company ran thermal baths in Portugal, offering treatments outside the Portuguese national health service. The company does not have the capacity to offer hospital care. A dispute arose over its claim to exemption for a supply called "thermal registration". This was a preliminary charge when consulting a doctor for a prescription of courses of treatment. Thermal registration was not charged for in relation to treatments lasting up to three days, but where required it was valid for a year. The tax authorities issued a decision that the supply was taxable, and issued an assessment together with interest.

At first instance, the Portuguese court upheld the trader's appeal, holding that the payment for the registration related to a single supply of medical care; the thermal cures provided a therapeutic function (unlike "thermal spa services"), and a consultation with a doctor took place.

The tax authority appealed, and the Supreme Court of Portugal referred questions to the CJEU. The tax authority argued that the registration process was not "closely related" to the provision of medical care. The referring court described the registration service as "opening, for each user, an individual file setting out the clinical history entitling the user to purchase 'traditional thermal cure' treatments", and asked whether such a supply fell within "closely related activities within art.132(1)(b) PVD.

The court started by recalling that exemptions must be interpreted strictly, but not so as to deprive them of their intended effect. As the referring court was satisfied that the treatments were therapeutic, there was a possibility that exemption would apply.

The court went on to draw a distinction between two possible interpretations, which it would be for the referring court to apply. On the one hand, the registration service might involve compiling an individual file, including the user's clinical history, setting out data relating to the user's state of health; that would be relevant to the provision of the appropriate care, and would be regarded as "closely related" to medical care. By contrast, where all that is obtained in return for the payment of the thermal registration fee is the possibility to purchase prescribed care, or if the content of the individual file including the user's clinical history is not essential for the provision of the care and for achieving the therapeutic objectives pursued, such an activity must not be regarded as 'closely related' to medical care.

If the activity was "closely related", it would still be necessary for the referring court to consider whether the taxpayer was the right kind of organisation to qualify for the exemption within art.132(1)(b). It was clearly not a hospital, so it would be necessary to consider whether the medical care and closely related activities that establishment provides are

undertaken under social conditions comparable to those applicable to bodies governed by public law, and whether it was a centre for medical treatment or diagnosis or other duly recognised establishment of a similar nature.

CJEU (Case C-513/20): *Autoridade Tributária e Aduaneira v Termas Sulfurosas de Alcafache SA*

2.3.4 Updated Manual

HMRC have updated the *Health Manual* with a new page setting out HMRC's policy on the VAT treatment of ultrasound scanning services for pregnant women following the FTT's decision in *Window to the Womb (Franchise) Ltd*.

VATHLT2011

2.4 Zero-rating

2.4.1 Zero rate of VAT for energy saving materials

The Spring Budget included the reversal of changes to the UK's reduced rate rules for installation of energy saving materials that were made in 2019 as required by a CJEU decision. Relief will no longer be restricted by social policy conditions or a requirement that the cost of the materials did not exceed 60% of the total value of the supply; wind and water turbines will be added back to the list of energy saving materials.

In addition to these permanent changes to the rules, supplies will be subject to the zero rate rather than the reduced rate for five years from 1 April 2022 to 31 March 2027.

Because Northern Ireland remains subject to the EU's VAT rules on supplies of goods, the list of qualifying goods and the rate of VAT on installations will remain unchanged.

These changes have been given effect by *The Value Added Tax (Installation of Energy-Saving Materials) Order 2022*.

SI 2022/361

2.4.2 Updated Manual

A new page has been added to the VAT *Food Manual* on plant growing kits and the extent to which they can and cannot benefit from zero-rating.

VFOOD3550

2.5 Lower rate

Nothing to report.

2.6 Computational matters

2.6.1 Lennartz mechanism

HMRC have published a Brief on the use of the *Lennartz* mechanism where a trader claimed 100% input tax relief on a mixed-use asset before 22 January 2010 and chose to continue to operate the mechanism over the life of the asset rather than "unwinding" it by reversing the input tax claim and ceasing to account for output tax.

The Brief highlights a potential anomaly caused by the increase in the standard rate of VAT in 2011 from 17.5% to 20%. This could result in the output tax payable exceeding the input tax originally claimed. The Brief confirms that, where the output tax paid equals the input tax originally claimed under *Lennartz* before the end of the economic life of the asset, businesses are not required to continue to account for the output tax on the private use of the asset.

It is not clear why HMRC have chosen to issue this Brief now, when very few organisations can still be using the mechanism. It may be related to the case of *Colchester Institute Corporation*, where the trader's unsuccessful claim for overpaid VAT depended on seeking to stop accounting for output tax using *Lennartz*.

Revenue & Customs Brief 6/2022

The VAT *Input Tax Manual* has been updated with guidance on the same point.

VIT25550

2.7 Discounts, rebates and gifts

Nothing to report.

2.8 Compound and multiple

Nothing to report.

2.9 Agency

2.9.1 Concession could not be claimed retrospectively

In 2021, two employment agencies applied to the High Court for judicial review of HMRC's decision to raise assessments on their supplies of medical staff. The basis for the appeal had to be judicial review because the treatment they wanted depended on the application of a concession, which cannot be appealed to the FTT. An initial appeal to the FTT had been withdrawn and replaced by the application for judicial review; this

was originally refused by a High Court judge on the basis that the FTT route was available, but this decision was later overturned by the Court of Appeal. There is also an outstanding appeal to the FTT on the grounds of exemption; the judge in the present case proceeded on the basis that the technical appeal was ill-founded, and considered only the question of whether HMRC's decisions were flawed.

One of the appellants (Delta) appealed against an assessment for £1.865m, raised in January 2017 for the period from 03/13 to 09/16; the other (1st Alternative) appealed against an assessment for £220,000 covering the period from 09/14 to 04/16. The claim was based on the protection of legitimate expectations, that the claimants said were derived from a letter written to Delta in January 2004, and also the ESC known as the Nursing Agency Concession.

The HC decision examined the correspondence between an officer and Delta in 2004. At that time, the agency was considering whether it should deregister on the grounds that it was supplying exempt medical care as a principal. The officer stated that it should continue to account for output tax on its commission, as it was supplying staff as an agent.

The staff hire concession was withdrawn by HMRC with effect from 1 April 2009. This allowed businesses that supplied staff as a principal to be treated for VAT as if they supplied them as an agent. Information Sheet 03/09 explained the terms of the withdrawal; this was further developed by R&C Brief 12/2010, which stated that employment businesses in the health and welfare sector would be treated as principals making exempt supplies of healthcare if they retained direction and control of its staff. The HC judge considered that this was inconsistent with the officer's letter of January 2004, which suggested that the agency would only be treated as an exempt principal if it employed its staff.

The Brief then set out the Nursing Agency Concession, which allowed the supply of registered nurses and midwives, and auxiliaries under the direct supervision of registered staff, and certain other unregistered staff supplied to hospitals and care homes to be treated as exempt supplies of healthcare, as long as the agency acted as a principal. The agency had to be registered with the Care Quality Commission in order to qualify for the concessionary treatment.

HMRC accepted that the claimants satisfied the criteria for the concession at all material times. However, they had not claimed the benefit of it at the time; they had accounted for VAT on their commissions on the basis that they were supplying staff as agent, and it was only when HMRC ruled that they were acting as a principal that they retrospectively claimed the concession.

There were a number of other developments in the area of employment agencies, including R&C Brief 32/2011 responding to the FTT decision in *Reed Employment Ltd*, and an update to Notice 700/34 made in June 2012. In all these developments, HMRC maintained the position (contrary to the January 2004 letter) that employment agencies could supply self-employed staff either as principal or as agent.

The claimants based their application on the assertion that HMRC's assessments, made on the basis that they were supplying staff as principals, and could not benefit from the concession, were in breach of a

legitimate expectation created by the letter of 14 January 2004 that, unless and until they reorganised their businesses, HMRC would regard them as acting as agents who should account for VAT only on their fees/commission; or that if they commenced making supplies as principals, those supplies would be regarded as exempt.

The HC judge noted the precedent of *Elmeka* (Case C-181/04) as setting out the EU principle of protection of legitimate expectations. In his view, the claimants could not reasonably have had a legitimate expectation covering the period 2013 to 2016, based on a letter written in 2004, when HMRC had published several statements in the intervening period that called the letter into question. "A reasonably prudent trader would have sought clarification from HMRC and would very likely have been informed that the 14 January 2004 letter did not reflect HMRC's up-to-date position." The claimants' counsel made submissions as to why his clients could not be expected to have been aware of the more up-to-date guidance, but this was not supported by witness evidence to show that they had not been aware of it or taken advice on their VAT position. The judge described the submissions as "implausible".

An argument based on a claimed EU principle that "the Member State cannot be permitted to take advantage of its own wrong" was also dismissed. That arose in the context of direct effect of Directives, where a Member State could not benefit from its failure properly to implement EU law. The "wrong" in this case was the incorrect letter of 2004, and that was not something that should have created a legitimate expectation in the trader's mind.

There was also an argument based on the domestic law concept of legitimate expectations, as set out in the 2019 Court of Appeal judgment in *R (Aozora) v HMRC*. In that case, the claimants had relied on an explanation of the law in HMRC's internal manuals; the judge noted that this was adverse to the present claimants, because it suggested that they ought to have followed more up-to-date HMRC guidance rather than an old letter. The judge had to consider whether it was unfair, "at a very high level", for HMRC to depart from the content of their letter. In his view, it was not. "The short point is that the assessments under challenge covered periods which fell a minimum of nine years after the letter and four years after the first of a series of publications which made clear to the informed reader that the position stated in the letter regarding agent status was no longer regarded by HMRC as correct."

The judge went on to consider whether the benefit of a concession could be claimed retrospectively, or whether it had to be elected for at the time, as HMRC argued. In line with the Court of Appeal decision in *ELS Group*, the judge concluded that HMRC were right.

The claimants' strongest argument was an appeal to basic fairness. They were not allowed to apply a concession retrospectively that would have resulted in them paying no VAT at all to the Exchequer; but HMRC were allowed to resile from a letter they had sent to the claimants and raise assessments retrospectively. The judge agreed that this was a little harsh, but the problem had arisen from the claimants' failure to pay attention to the various later statements emanating from HMRC.

Lastly, the judge considered a claim based on the principle of equal treatment. It was not possible for a valid claim to be justified solely

because other taxpayers were treated too generously. The claim for judicial review was dismissed.

Court of Appeal

The companies appealed to the Court of Appeal on the question of whether the concession could be claimed retrospectively. The appeal on the question of exemption is still stood over by the FTT.

Mr Justice Zacaroli gave the leading judgment, with which Lord Justice William Davis and Lady Justice Asplin agreed. He analysed the *ELS* judgment at some length, as it was relied on by both parties. He went on to note that there was nothing in the concession to create a legitimate expectation that it could be applied retrospectively: the judge agreed with HMRC's counsel that "*the NAC would be understood by the ordinarily sophisticated taxpayer as requiring a choice to be made in relation to each supply at the latest by the time the client is invoiced in respect of that supply. That is because the choice to exempt a supply requires positive action by the taxpayer. To 'exempt' a supply means not to charge or account for VAT on it. The positive action required by the taxpayer is to exclude, rather than include, VAT when invoicing its client. The choice 'to exempt' a supply is therefore one that has necessarily to be made at the time of the supply.*"

The fact that the appellants in the current case had charged VAT (the wrong amount, being based on the commission) had real consequences that could not be undone. That put them in a worse position than the appellants in *ELS*, who had wrongly treated the whole of their supplies as exempt.

There was no significant difference between the doctrine of legitimate expectation in UK and EU law. The judge dismissed relatively briefly arguments raised by the appellants' counsel that they had a stronger case under the EU legal principle.

The judge also dismissed an argument that the companies had claimed the benefit of the exemption by what they had said in correspondence in 2004. The most that could be said was that, because they did not appreciate they were supplying nurses as principal, the appellants gave no thought to the concession as they thought it did not apply to them. The judge did not see any way in which that can be viewed as a choice made by the appellants, when they made supplies in the period 2013 to 2016, to exempt those supplies from VAT.

The appeal was unanimously dismissed.

Court of Appeal: *First Alternative Medical Staffing Ltd and another v HMRC*

HMRC have updated the Notice *Health professionals and pharmaceutical products* with further information about the nursing agencies' concession based on this decision. Section 6.6 confirms that the concession can only be claimed prospectively, and also cannot be claimed where input tax is recovered by the supplier on related costs (because that is inconsistent with exemption).

VAT Notice 701/57

2.10 Second hand goods

2.10.1 Northern Ireland margin scheme

HMRC have updated their guidance on sales of second-hand motor vehicles in Northern Ireland. The government intends to introduce a new second-hand motor vehicle export refund scheme on 1 October 2022. It will replace the VAT margin scheme for second-hand vehicles bought in Great Britain and moved to Northern Ireland before being resold.

Until the new scheme is introduced, businesses should continue to follow HMRC's guidance on the existing VAT margin scheme. Cars sold from 1 January 2021 will be eligible for an adjustment to the output tax, as long as the amount reclaimed is paid back to the customer.

Further detailed guidance will be issued in May 2022.

www.gov.uk/guidance/sales-of-second-hand-motor-vehicles-in-northern-ireland

2.11 Charities and clubs

Nothing to report.

2.12 Other supply problems

2.12.1 Vouchers for staff

Advocate-General Capeta has given an opinion in a case referred from the UK about the consequences of an employer issuing vouchers to staff as part of an employee rewards programme. Employees could nominate other employees for work "above and beyond" (the name of the programme); after an internal approval process, the nominated employee could be awarded a retail voucher, which could be selected from a list of participating retailers on a website managed by a scheme promoter, G.

G purchased the vouchers from the retailers and sold them to the employer's group company in the USA. They were then sold on to the headquarters of the employer, also in the USA, before being transferred as a cross-border supply to the UK companies in the group that employed the relevant workers. They were then supplied to the workers. The UK companies accounted for a reverse charge on the cross-border receipt of the vouchers, and deducted the same amount as input tax. When the employee redeemed the voucher, the retailer would account for output tax on the supply of goods or services.

In December 2017, HMRC raised an assessment for £330,000 on the UK companies in respect of undeclared output tax on the transfer of the vouchers to the employees. The basis of the assessment was a deemed supply of services on which input tax had been deducted following which the services were put to a use other than the purposes of the business. The FTT decided to refer questions to the CJEU on the interpretation of PVD

art.26(1)(b), which is the basis of the relevant UK provision (SI 1993/1507). The questions referred were:

(1) Does the issue of vouchers for third-party retailers to employees by a taxable person as part of a recognition programme for high-performing employees constitute a supply "for his private use or for that of his staff or, more generally, for purposes other than those of his business" within the meaning of Article 26(1)(b) of the… VAT Directive?

(2) Does it have any significance in answering question 1 that the taxable person has a business purpose for the issuing of the retail vouchers to staff?

(3) Does it have any significance in answering question 1 that the retail vouchers issued to staff members are for their own use and can be used for the staff members' private purposes?

The referred case is a lead case for other appeals featuring similar facts and 19 other members of the same corporate group.

The A-G starts by considering the concept of "private use or for that of his staff or, more generally, for purposes other than those of his business" in art.26(1)(b). It was agreed that the transfer of the vouchers constituted a supply of services and that it was free of charge; the only question was whether the services were provided for private or business purposes.

The company argued that the subjective intention of the transferor taxable person was relevant: if the purpose of the free supply of services was to benefit the business, art.26(1)(b) should not apply. The A-G considered that the starting point of the PVD was an assumption that the free supply was for private use, and in that case the taxable person should be treated as a final consumer. For example, the transport of workers to building sites in *Filibeck* was "necessary" in that it would otherwise have been difficult to get the workers to the sites; it did not mean that transporting employees to their place of work could always be provided without a VAT charge, even if the employer subjectively considered that to have a business purpose. It had also been relevant in both cases that the provision of the free services was at all times under the control of the taxable person. Although there might have been some private benefit to the employees, nevertheless that was incidental to the business purpose underlying the provision.

The A-G considered the referred questions together. Applying the principles already discussed, she concluded that there was not the requisite element of necessity or control in the employees' use of the vouchers to bring them within the principles of the precedent cases. As a result, the transactions appeared to fall within art.26(1)(b).

She then went on to consider whether this might create a double charge to tax. She gave a comparison with the simple provision of "straightforward goods or services" (e.g. a microwave): there would be an output tax charge on the transfer to the employee, and that would ensure that consumption was taxed once and once only. Because this was a transfer of a voucher, which would also be charged to output tax on the redemption by the retailer, there was a possibility that there would be a double charge on the same consumption.

The A-G questioned whether the CJEU decision in *AstraZeneca UK* had been correctly interpreted as requiring all transfers of vouchers to employees to be treated as chargeable transactions. She pointed out that that case had concerned the application of art.24 PVD – it was about the classification of the transfer of the vouchers as a supply of services, given that it was "something done for a consideration other than a supply of goods". It was not about the application of art.26.

The A-G drew a distinction between "the transfer of a right 'as such'" and "the transfer of a 'right to a future supply' of goods and services". A transfer of a right 'as such' had to be regarded as a taxable event because the recipient was immediately entitled to the underlying good or service without a subsequent event. The right to a future supply did not have the requisite level of certainty to create a chargeable event: it was comparable to a "multi-purpose voucher", as set out in the Directive (2016/1065) which reformed the VAT treatment of vouchers.

The A-G suggested that it was for the referring court to determine exactly what types of vouchers were involved, but alternative answers to the questions referred were suggested:

Unless all the relevant information concerning the right to a supply of goods or services is already known when a voucher is transferred from a taxable person to his or her staff, that transfer does not constitute a taxable transaction within the meaning of [art.62 PVD].

It falls to the referring court to determine whether the transaction at issue in the main proceedings satisfies those requirements.

In the alternative, I propose that the Court reply to the questions posed to it as follows:

The transfer of vouchers free of charge to employees by a taxable person as part of an employee recognition scheme, such as that in the present case, without that taxable person requiring any link to his or her economic activity or exercising any control over the use of those vouchers, constitutes a supply 'for [the taxable person's] private use or for that of his staff or, more generally, for purposes other than those of his business' within the meaning of [art.26(1)(b) PVD].

It is of no significance to that conclusion that the taxable person has a business purpose for the issuance of such vouchers.

CJEU (A-G) (Case C-607/20): *GE Aircraft Engine Services Ltd v HMRC*

In an article in *Taxation*, Waqar Shah and Tabassum Khan discuss the VAT treatment of employee incentives and vouchers in light of the above opinion.

Taxation, 24 March 2022

2.12.2 City cards

A-G Capeta has also given an opinion in another case, referred from Sweden, on a different kind of voucher: a "city card" sold to visitors to Stockholm, entitling them to admission to about 60 attractions for a limited time and up to a set value. The card also gave unlimited rights to certain transport services and sightseeing tours. The services included in the card are either subject to tax, at various rates, or are tax exempt. The

card is presented to be read by a special card-reading machine; once the value limit has been reached, the card is no longer valid, apart from the unlimited right to use transport services.

The parties to the dispute disagreed on the classification of the card. The tax authority considered that the high value and short duration suggested that it was expected that customers would not reach the value limit, and this meant that it was not a voucher at all. The company considered that it should be a voucher because suppliers were obliged to accept it as consideration. The referring court noted that city cards had been discussed by the VAT Committee when the present rules on vouchers were being developed, but that no consensus had been reached. The question referred was whether they were vouchers, and if so, whether they were multi-purpose vouchers.

The A-G began by considering the history of the treatment of city cards by different member states. Some regarded them as a credit transaction, exempt from VAT. Some regarded them as fully taxable on the face value; others regarded them as taxable on the face value after deduction of the amounts paid for actual provision of the services. Of these three, only the third "profit margin" option would be applicable if the cards were to be treated as multi-purpose vouchers. The other two would be contrary to the 2016 vouchers directive: that sought to distinguish vouchers from credit transactions, ruling out exemption, and also did not approve taxation of supplies that ought to be exempt, which would apply to some of the underlying services covered by the card (such as admission to museums).

The A-G went on to consider the 2016 directive. In her view, this did not seek to change the treatment of vouchers but rather to rationalise it; it did not create an exception to the normal rules of VAT that would require narrow interpretation, contrary to the submissions of the Italian government and the Swedish tax authority.

The directive introduced the definition of a voucher that is now found in art.30a(1) PVD: an instrument that entails an obligation to accept it as consideration or part consideration for a supply of goods or services and which contains information about the goods or services for which the voucher can be used as consideration, or, alternatively information about the potential suppliers. This definition does not include all instruments that are commonly referred to as vouchers: for example, 'discount vouchers' are excluded from the VAT Directive's definition, even if they were included in the original proposal for the 2016 Directive. They do not meet the definition because they cannot be used as consideration on their own. The A-G commented that a city card cannot be treated as a voucher simply because it is called one; it has to meet the conditions of the PVD definition.

The definition requires that the instrument must encompass an obligation for the suppliers of goods or services to accept it as consideration or part consideration for a supply of goods or services they provide, and the goods or services to be supplied or the identities of their potential suppliers are either indicated on the instrument itself or in related documentation. The A-G commented that something had to satisfy both these conditions to be regarded as a voucher; however, it was not

necessarily the case that every instrument that satisfied the conditions was a voucher.

There is a wide variety of city cards available under different schemes. The A-G noted that not all would satisfy the conditions, and their classification as vouchers had to be considered on a case-by-case basis. She went on to examine whether there were good reasons for excluding even those that met the definition from being treated as vouchers. She examined the arguments put forward by the tax authority – mainly that the city cards did not enable customers to see how the value reduced as they were used, and that part of the value represented an effective "subscription" for unlimited transport services – and did not consider them good enough reasons to exclude the city cards from being regarded as vouchers.

What was much more important was the correct application of special treatments to the underlying supplies – the use of the voucher to purchase exempt services. As the use of the voucher for different purposes was not known at the time the voucher was purchased, it had to be a multi-purpose voucher. The A-G then very quickly came to the conclusion that the "profit margin basis of taxation" should be adopted, which would give rise to a comprehensive, uniform, transparent and neutral tax scheme for such vouchers, even though it is perhaps not explicitly recognised by the PVD.

The answer suggested by the A-G is:

A card that suppliers are obliged to accept as consideration for the supply to cardholders of the goods or services included in that card at a given place for a limited period of time and up to a certain value, falls within the scope of the concept of 'voucher' within the meaning of [art.30a PVD]. That is so even if all services covered by such a card cannot be used within a given time by an average consumer. Such a card is a 'multi-purpose voucher' within the meaning of the same provision, whenever the tax on the supply of goods and services for which it must be accepted as consideration is not known at the moment of transfer of that card.

CJEU (A-G) (Case C-637/20): *Skatteverket v DSAB Destination Stockholm AB*

2.12.3 State Aid and distortion of competition

In 2016 and 2018, the Upper Tribunal considered an appeal by a company that operated in waste disposal. It argued that HMRC were wrong to treat commercial waste disposal services supplied by a local authority as outside the scope of VAT, because that represented unfair competition for the commercial sector. The appellant company had to charge VAT to its customers; if they could not recover that VAT, the fact that the local authority did not have to charge VAT created a fiscal disadvantage. The Upper Tribunal concluded that there was not a compelling argument that the "distortion of competition proviso" required the local authority to be treated as a taxable person, and it was acting in its capacity as a public authority.

The company returned to court with another judicial review application, this time arguing that HMRC's decision to allow the local authority not to charge VAT constituted an illegal State aid contrary to the EU Treaty.

The appellant contended that the respondent was able to charge lower prices for its commercial waste collection services because the respondent used the same infrastructure for providing those services as it did for providing its household waste collection services and thereby cross-subsidised the provision of its commercial waste collection services out of its general revenues, and in particular its revenues from council tax.

The application was dismissed in a summary judgment by a High Court judge, and the Court of Appeal has now confirmed that decision in a majority decision. The High Court judge had concluded that the company had failed to show that any breach of the TFEU would be sufficiently serious to warrant an award of damages, and also found that the authority was not in a legal and factual situation comparable to that of the commercial company. Arnold and Coulson LJJ upheld these decisions, but Edis LJ gave a dissenting judgment. Even he conceded that allowing the application to proceed would probably end up with the claim for damages being dismissed.

Coulson LJ noted that there had never been a successful damages claim against a member state for a breach of the State aid provisions (referred to as "*Francovich* damages" after Case C-6/90 in which the possibility was recognised by the CJEU). He commented: "Was this claim really going to be the first ever, when to win TDC would have had to distinguish the judgment of Warren J completely, and persuade a court that it was a reasonable and sensible solution for the Council's bin lorries to ignore the commercial waste left out on the street, and leave that waste for a second fleet of bin lorries, this time operated by TDC, to pick up instead? The answer must be a resounding 'No'."

Court of Appeal: *Durham Company Ltd v Durham County Council*

2.12.4 Weddings and civil partnership ceremonies

A new chapter has been added to the VAT *Government And Public Bodies Manual* to clarify when they may be subject to VAT.

VATGPB8876

2.12.5 Article

In an article in *Taxation*, Kevin Hall discusses the conditions for treating a transfer of business assets as a VAT-free transfer of a going concern, including the important impact of VAT grouping following the *Intelligent Managed Services Ltd* decision in the Upper Tribunal.

Taxation, 13 January 2022

3. LAND AND PROPERTY

3.1 Exemption

3.1.1 Licence to occupy

A company owned premises with two floors, operating a hairdresser's salon on one of them. The company rented rooms on the other floor to beauticians. Rent was based on a percentage of the beauticians' takings, and there were some common facilities such as the staff toilet. HMRC formed the view that the rent was taxable and raised an assessment for £18,649. The company appealed to the FTT.

Judge Anne Fairpo set out the characteristics of a letting or leasing of immovable property in EU law:

(1) the arrangement must relate to a defined area of immovable property;

(2) it must confer a right to occupy that property, to the exclusion of all others;

(3) for an agreed period; and

(4) for payment.

HMRC accepted that the supply was of a defined area, but argued that the other conditions were not supported by evidence. The judge considered each of the points in turn. Although formal leases were not entered into until December 2018 (after the period covered by the assessment), the judge accepted that the leases reflected the nature of the supplies throughout.

The possibility of the owner accessing the rooms was no more than is usual in any lease. The judge found that there was no intention for the owner to exercise any control over the rooms, and the tenants had the right to exclude others.

There was no formal period covered by the agreements, but the judge concluded that there was an informal agreement that the rooms were let for a defined period of one month, renewable on a rolling month-to-month basis. There were no submissions that such an arrangement did not amount to a defined term.

The judge noted HMRC's submission that a percentage of turnover does not meet the condition that payment must be given for a defined area. She found them "somewhat surprising" as turnover rents are not uncommon. The lease clearly provided for the payment of rent, and satisfied the conditions.

The four conditions were all therefore satisfied, and the supply was not precluded from being treated as a supply of land. The remaining question was whether there was a supply of other services to which the land supply was ancillary, in line with the principles of either *Card Protection Plan* or *Levob*. HMRC argued that the services constituted "active exploitation" of the rooms, citing the case of *Byrom (t/a Salon 24)* as a relevant decision. That concerned the letting of rooms to masseuses and involved considerable extra services, not least in provision of personal security which was necessary because of the nature of the business carried on.

The judge had no difficulty in distinguishing *Byrom*. She discussed the provision of reception services and the possible inclusion of the beauticians in the owner's insurance policy, and concluded that any additional elements were ancillary and incidental to the passive supply of land. The beauticians were not required to use the other services and could operate without them.

The appeal was allowed.

First-Tier Tribunal (TC08370): *Errol Willy Salons Ltd*

3.1.2 Accommodation for homeless people

City YMCA is a charity that runs hostels in London for homeless young people. It had in the past supplied some welfare services, but since 2010 had treated its supplies as wholly standard rated accommodation, subject to the reduction in chargeable value to 20% of the total under VATA 1994 Sch.6 para.9 where people stayed for more than 28 days. This meant that it was able to recover input tax on all of its costs, while only accounting for output tax on a proportion of its income.

HMRC carried out a number of visits in 2014, 2017 and 2018, and variously suggested that the supply would be exempt as welfare and then agreed that it was standard rated as "a similar establishment to a hotel". That excludes exemption under Sch.9 item 1(d), which in turn brings in the valuation rule in Sch.6. In January 2019, an officer issued a ruling that the accommodation was not "similar to a hotel" and was therefore not within item 1(d), so the supplies were exempt; on 1 March 2019, the same officer reversed that ruling and stated that the supplies were taxable, but did not qualify for the 28-day rule. This was based on the assertion that the supplies did not constitute a supply of land because the residents did not gain exclusive possession of the property. HMRC proposed to apply this new ruling from the date it was issued, and not to assess for tax on previous supplies.

Judge Heidi Poon set out in some detail how the hostels operated. She considered how people applied for a room, how their rent was financed (usually from housing support grants), how long they generally stayed, and the terms and conditions of the agreements between residents and the YMCA.

The appellant's counsel submitted that the licence agreement constituted a licence to occupy land. The terms and conditions that HMRC considered to rule this out were "unexceptional" standard terms in hotels and similar establishments, allowing access to rooms for purposes such as maintenance or in an emergency. Although the hostel could require a resident to move to a different room, this was not inconsistent with a licence to occupy land, and was supported by the reasoning in the *47 Park Street* case. Although residents had the use of some communal areas and facilities, that was incidental to the dominant supply, which was a licence to occupy a room.

Some attention was paid to Clause 7 of the agreement, which stated that "this agreement is not intended to confer exclusive possession on the licensee nor to create the relationship of landlord and tenant between the parties". The appellant's counsel described this as a "labelling type provision", which was to prevent the agreement giving rise to statutory

security of tenure, but was not relevant to the VAT treatment. That was determined by EU precedents, and the clause had to be interpreted in the context of the economic reality of the situation. What was actually provided to the residents in return for payment was the right to occupy a room.

The appellant's counsel put forward a number of arguments to show that the hostels were similar to a hotel. These included the layout, the services provided, and the absence of other services such as education or medical care.

HMRC relied on clause 7 to show that the supply failed the basic tests of a leasing or letting of immovable property under EU law. There were other clauses in the contract that contradicted the right to admit or exclude people. Although the commercial and economic reality of a situation should be considered in determining the VAT treatment, such clear terms in the contract should not be ignored, and exemptions had to be strictly construed and narrowly interpreted. The supply was an active provision of facilities rather than a passive supply of land for rent.

HMRC then set out a number of further arguments to distinguish the hostels from hotels, in case the supply was held to be within item 1(d). These included the selection of residents and the purpose underlying the service, which was to assist homeless young people in improving their lives and gaining access to other support agencies.

The judge noted that the best result for the appellant would be for the supply to be taxable but eligible for the 28-day rule, because most of the residents stayed for over 28 days. She began her analysis by citing the CJEU decision in *Newey* in relation to the characterisation of supplies. The contract is to be followed in the first instance, because it usually reflects what is happening; however, some contractual terms may not represent the commercial and economic reality of the transactions, in which case the reality should override the contract. In *Newey*, the CJEU emphasised that this was likely to be the case where the national court considered it needed to prevent tax evasion, avoidance or abuse or to recharacterise wholly artificial arrangements that were set up with the sole or main purpose of obtaining a tax advantage. She also referred to the Supreme Court judgment in *SecretHotels2*, which emphasises the importance of contractual agreements, unless it is established that they constitute a sham.

After further considering the way in which exemptions should be construed, the judge set out the tests of whether a supply constituted a leasing or letting of immovable property by reference to the *Temco* case. It would have to contain the following five elements:

(1) Transfer of immovable property;

(2) To the exclusion of all others;

(3) Of the use and enjoyment thereof;

(4) For an agreed term;

(5) In exchange for the payment of rent.

The agreement expressly provided for (1), (3), (4) and (5). The crux of the dispute was therefore whether the appellant granted the residents

enjoyment of their allocated room "to the exclusion of others", in spite of clause 7. The judge gave lengthy and detailed reasoning for concluding that this was the economic reality, and the various labels that were applied to the transaction in the agreement could not override that. It was a licence to occupy land.

The judge then considered HMRC's further argument that the "added value" facilities meant that the land supply was only incidental to the active exploitation of that land. She set out the list of other services that appeared to be included, and noted that 95% of the daily charge appeared to relate specifically to the accommodation. The preponderant element of the supply was the land, and the other aspects were incidental.

In relation to the interpretation of "hotel or similar establishment", the judge referred to the opinion of A-G Jacobs in *Blasi*, which included the comment that the Directive wording ("sectors with a similar function") should be given a broad construction in order to preserve fairness of competition between supplies of accommodation. In the same opinion, the A-G set out the differences between hotel accommodation and other residential accommodation. The judge "distilled" the following principles for construction of item 1(d):

(1) 'similar establishment of sleeping accommodation' is to be construed broadly;

(2) 'similar establishment' is to be given a purposive construction, having regard to the purpose of the provision by the hotel sector as that of temporary accommodation;

(3) A functional approach is to be adopted in construction by assessing whether the accommodation provision in question is in 'potential competition' with the hotel sector.

Applying that broad construction, the factors that HMRC considered were dissimilar to hotels became less relevant. If a room could not be found in a YMCA hostel, the local authority might have to put the person up in a hotel; the functional approach required equal treatment for competing establishments.

The appeal was allowed.

First-Tier Tribunal (TC08351): *City YMCA London*

3.1.3 Market pitches

A company ran car boot sales in a field weekly for more than 40 years. Sellers simply turned up and paid a small amount of money (around £10) for a marked pitch in which they could sell their goods. In December 2019 HMRC issued an assessment for £83,000 to cover the periods from 12/16 to 03/19; by the time of the hearing, a further assessment had been issued for £53,000 in relation to later periods.

When the business started, the owner had asked for confirmation that he did not need to charge VAT. He was told by Customs & Excise that he should do so, and so he registered and accounted for output tax. After some years he presented evidence to the VAT office that other similar businesses were not charging VAT on pitch fees, and all the VAT the company had paid was refunded with interest. The company then ceased to charge VAT on pitch fees "on the basis that they are zero-rated" (the

judge's words in the decision – it is not clear whether this is actually the judge's misrepresentation or the taxpayer's misunderstanding, but it is repeated numerous times throughout the decision).

HMRC argued that the company was providing extensive added value facilities in the same way as *International Antiques and Collectors Fairs* (TC04538) and *Zombory-Moldovan t/a Craft Carnival* (Upper Tribunal 2016). The company's publicity referred to a "5-star café", but the owner explained that this referred to its hygiene rating rather than its gourmet menu. There were also toilet facilities in a portacabin, but minimal other services. The judge found as a fact that the facilities were minimal.

The judge noted that the officer who made the decision did not visit the site, and based his decision on a telephone discussion with the owners in which he referred to *Zombory-Moldovan*. The decision letter referred to a list of additional services including the reputation of the established site, advertising, amenities, parking, capital improvements to the site and cleaning up afterwards.

Judge Marilyn McKeever reviewed the possible similarities between this case and *International Antiques and Collectors Fairs* (which was not binding on the Tribunal) and *Zombory-Moldovan* (which was). In her view, the services provided were so much more basic that what was supplied was no more than a licence to occupy land. The appeal was allowed.

First-Tier Tribunal (TC08395): *Rufforth Park Ltd*

3.1.4 Break clause

A lease contained a break option under which the tenant was entitled to terminate the lease on payment of £112,500 "together with any VAT properly due thereon". The tenant sought to exercise the option to terminate and made a payment of £112,500 but added nothing in respect of VAT. The landlord refused to accept that the lease had been validly terminated, and the dispute between the parties reached the Court of Session. The issue was whether VAT was "properly due" on the option payment.

The option to tax had been exercised by the landlord in July 2013, and the break clause was purportedly exercised by the tenant in February 2021. The landlord's agents wrote to the tenants in June 2021 stating that the break option had not been validly exercised because the payment should have been £135,000. They proposed to return the £112,500 and to consider the tenants still bound by the lease.

Lord Ericht noted that new guidance had been issued by HMRC on early termination of contracts in R&C Brief 12/2020 on 2 September 2020, but that this was suspended on 25 January 2021. He noted that the January 2021 statement said that traders could "go back to treating [early termination payments] as outside the scope of VAT, if that is how they treated them before this brief was issued." He went on to quote the passages from the HMRC internal manuals that were referred to in the Brief, including in particular VATSC05910, VATSC05920 and VATSC05930. Note that these have now been further revised following the issue of R&C Brief 2/2022.

The plaintiff landlords applied for a court order declaring the break option had not been validly exercised. This would require the court both to conclude that the payment should have been VATable, and that the landlord would be entitled to be paid the VAT without asking for it. The lease referred to the tenant having the obligation to reimburse any VAT to the landlord "on demand". The plaintiff's counsel argued that the demand was "already there in the wording of the lease". The plaintiff also argued that there was no obligation on the landlord to tell the tenant that the payment was deficient while there would still have been time to correct it. The plaintiff had done nothing to induce any particular belief in the defender, and the plaintiff's silence could not be taken as consent.

The defender's counsel argued that the liability for the VAT rested with the landlord. The purpose of the VAT clause in the lease was to ensure that the tenant indemnified the landlord against demands for VAT from HMRC; it was not necessary to add VAT to the payment until the landlord confirmed that VAT was due, in which case the landlord should have issued a VAT invoice. At the date the break clause was exercised, R&C Brief 12/2020 had been suspended, and HMRC would not have required the landlord to account for VAT.

The judge noted that it was HMRC's previous policy that VAT was not due where a break clause was included in the original lease, as confirmed in the 1996 VAT Tribunal decision in *Lloyds Bank plc* (VTD 14,181). The Tribunal had noted that this was HMRC's policy, but "as that policy is based neither on a provision of law or on decided authority, it does not bind the Tribunal".

The judge summed up the issue briefly: had anything happened between the *Lloyds* case and the notice of 23 February 2021 to change the VAT position? In his opinion, there had been no such change. There had been no cases on terminations of leases. The two CJEU cases that led to R&C Brief 12/2020 (*MEO* and *Vodafone Portugal*) were not directly in point: they related to failures to fulfil a minimum contracted term, rather than a pre-agreed break clause exercisable at particular times during a lease. The option payment did not correspond in any way to the rent that would have been payable if the lease had continued for its full term.

The judge was satisfied that the words "VAT properly due" meant "due to HMRC". At the time the payment was made, HMRC would not have demanded it. If they subsequently changed their policy with retrospective effect, the indemnity provisions in the lease would protect the landlord.

The judge commented that he did not accept the defender's argument that VAT was not due unless the landlord demanded it. In his view, the lease clearly contemplated the payment of "VAT properly due" without being demanded.

The judge also commented on the issue of a "personal bar" in that the defender alleged that it had relied on conversations with the landlord in which the landlord could and should have indicated that the option payment was insufficient. If the judge had decided that VAT had been due, he would have allowed the case to "proceed to proof" (i.e. the evidence about these conversations would have been considered).

The defender's main plea was upheld, in that the break clause had been validly exercised.

Court of Session: *Ventgrove Ltd v Kuehne + Nagel Ltd*

3.2 Option to tax

Nothing to report.

3.3 Developers and builders

3.3.1 Updated Manual

A note has been added to the VAT *Construction Manual* to clarify that scaffolding services may be liable to the domestic reverse charge.

VCONST02750

3.4 Input tax claims on land

Nothing to report.

4. INTERNATIONAL SUPPLIES

4.1 E-commerce

Nothing to report.

4.2 Where is a supply of services?

4.2.1 Conflict between member states

Advocate-General Kokott has given an opinion in a case in which both the Portuguese and Hungarian authorities claimed that they had the right to tax a transaction on the basis of a place of supply in their territory. The A-G noted that the Directive had been correctly transposed into domestic law in both countries, and the situation would give rise to genuine double taxation of one and the same transaction despite full harmonisation of the law. That contravened a number of underlying principles of VAT, in particular the neutrality of the tax.

The dispute concerned decisions of the Portuguese and Hungarian tax authorities on the place of supply of IT support services provided by a Hungarian undertaking (D) to a Portuguese undertaking (L). The case was related to an earlier dispute involving another Hungarian undertaking, WebMindLicences (WML), which was the subject of a reference to the CJEU some years ago (Case C-419/14). In that case, the question was whether it was an abuse of rights for a business established in a member state with a high rate of tax to use a fixed establishment in another member state to make supplies to consumers there at a lower rate. The answer was that the referring court had to analyse all the circumstances to decide whether the arrangement was wholly artificial, or whether the fixed establishment genuinely had the appropriate structure in terms of premises and human and technical resources to make supplies and engage in economic activity in its own name and on its own behalf, under its own responsibility and at its own risk.

The appellant in the present case considered that the required analysis had been carried out and the answer was that there was a genuine fixed establishment making supplies in Portugal. However, the Hungarian tax authorities maintained that the operation was solely operated by WML in Hungary, and the logical consequence was that the IT support services supplied by the Hungarian business to L must in reality be supplied to the main establishment in Hungary.

The connection between D, L and WML was not spelled out in the order for reference, but one of the questions suggested that the owner of WML is also the manager and/or owner of D. D supplied services to L comprising support, maintenance and construction of websites amounting to some €8 million between December 2009 and the end of 2011. L was incorporated in Portugal in 1998 and its principal activity in the relevant period was the provision of electronic entertainment services.

D was subject to a tax inspection by the Hungarian authorities, who decided that its supplies were in reality made to WML rather than to L; as

a result, the place of supply was Hungary and Hungarian output tax was due. Assessments were issued in February 2020 for VAT of approximately €1.25 million, together with a penalty of €1 million and default interest of €350,000 on the basis of a finding that the services provided by the website were supplied by WML rather than by L, and the licence agreement between L and WML was fictitious.

The company appealed, and the tax authority asked the Portuguese authorities to clarify the facts. In the company's submission to the CJ, it claimed that the answer clearly showed that L was established in Portugal and carried on an independent economic activity there, and was therefore capable of receiving supplies from D. The Hungarian court decided to refer questions to the CJ because of the possible disagreement between the two tax authorities, leading to a potential double charge to VAT.

The questions referred set out the circumstances of the case in unusual detail, given that the procedure normally deals with questions of principle. The facts about L are all given as part of the question:

"…the acquirer of the licence:

(a) had rented offices in the first Member State, IT and other office infrastructure, its own staff and extensive experience in the field of e-commerce, as well as an owner with extensive international connections and a qualified e-commerce manager;

(b) had obtained know-how reflecting the processes for operating the websites and making updates to them, and issued opinions on, suggested modifications to, and approved those processes;

(c) was the recipient of the service that the taxable person provided on the basis of that know-how;

(d) regularly received reports on the services provided by the subcontractors (in particular, on website traffic and payments made from the bank account);

(e) registered in its own name the internet domains allowing access to the websites via the internet;

(f) was listed on the websites as a service provider;

(g) took steps itself to preserve the popularity of the websites;

(h) itself concluded, in its own name, the contracts with partners and subcontractors that were necessary in order to provide the service (in particular, with banks offering payment by bank card on the websites, with creators providing content accessible on the websites and with webmasters promoting that content);

(i) had a complete system for receiving revenue from providing the service in question to end users, such as bank accounts, full and exclusive powers of disposal over those accounts, an end user database enabling end users to be invoiced for that service and its own invoicing software;

(j) indicated on the websites its own headquarters in the first Member State as the physical customer service centre; and

(k) is a company independent of both the grantor of the licence and the Hungarian subcontractors responsible for carrying out certain technical processes described in the know-how…

The questions appear to proceed on the assumption that WML does provide the services through the website to the consumers in Portugal. The question therefore asks whether the granting of a licence from WML to L, in the circumstances in which WML supplies the services but L has all the trappings of economic activity, produce the answer that L can be treated as the recipient of the cross-border support services.

The A-G starts by noting that the place of supply appears to be irrelevant, if both potential recipients (L and WML) are entities with a right of deduction. However, the appellant in the case (D) is required to account for output tax if the supply is situated in Hungary, and is not required to do so if the supply is situated in Portugal.

It was clear that L was a business established in Portugal, and WML was a business established in Hungary; the place of supply rules for these services, both before and after the rules changed on 1 January 2010, was the place of establishment of the recipient of the service. The question was therefore to determine the "true recipient" – L or WML. The referring court also asked a subsidiary question about the possible impact of a finding of abuse of rights in the granting of the licence.

The A-G recommended that the questions should be substantially shortened and rephrased: in effect, the referring court was asking whether the various provisions of the PVD must be interpreted as meaning that, in the circumstances of the present case, the contracting party governed by civil law that paid the consideration (L) is the recipient of the supply, on the basis of which the place of supply is determined; or whether the possible existence of an abusive practice between the contracting party and a third party (WML) mean that that third party is to be regarded as the recipient of the supply, and the place of supply is determined on that basis.

The A-G divided her opinion into three sections:

- determination of the recipient of the supply
- possible impact of abuse of rights
- problem of conflicting determinations by different tax authorities

The determination of the "correct" recipient is determined by general principles under the PVD, whereas a finding of abuse depended on an assessment of the facts. Such a finding would require a recharacterisation of the transactions so as to re-establish the situation that would have prevailed in the absence of those transactions. The fact that the two businesses concerned could deduct input tax counted against a finding of abuse, because it was not obvious what tax advantage they could obtain, even with a lower tax rate in Portugal than in Hungary.

According to general principles, a taxable supply of services exists where there is a legal relationship between a provider of the service and a recipient pursuant to which there is reciprocal performance. In that relationship, the remuneration received by the provider of the service constitutes the value actually given in return for the identifiable service supplied to the recipient. This is the case if there is a direct link between the service supplied and the consideration received. In the present case, there was a contract between L and D, and L paid for the service. There was no contract between WML and D, and WML made no payment.

According to general principles, therefore, L had to be regarded as the recipient of the service, and L's place of establishment would determine the place of supply.

The A-G disagreed with the Hungarian authorities that the place of supply could be shifted by an abusive practice for several reasons:

- fiscal neutrality – VAT was charged on transactions regardless of any problem with the legal basis of those transactions or the parties to them;
- the supplier had to be able to determine the liability of the supply from information available to it, which would not normally include abuse by the recipient;
- people acting in their own name on behalf of someone else were normally treated as receiving supplies for VAT purposes.

This outcome might be different if the court concluded that the entire legal structure between all three parties (D, L and WML) was a single "significantly abusive" arrangement. That did not appear to be contemplated by the reference for a preliminary ruling.

The A-G then considered what would happen if the two tax authorities maintained their contrary positions. A double charge to VAT was contrary to the principles of VAT. It could arise from a divergent interpretation of the rules, or a divergent assessment of the underlying facts. The authorities in the two countries had the obligation to exchange information in accordance with Directive 904/2010 and to reach agreement by way of the VAT Committee (PVD art.398). If those possibilities were exhausted, then reference should be made to the CJEU.

CJEU (A-G) (Case C-596/20): *DuoDecadKft v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága*

4.2.2 Updated Manual

The introduction to HMRC's *Place of Supply of Services Manual* has been updated with a revised definition of a 'supply to a relevant business person':

A supply is treated as B2B where the customer is a relevant business person. A person is a relevant business person in relation to a supply of services if:

(a) the person carries on a business, and

(b) the services are not received by the person wholly for private purposes,

whether or not the services are received in the course of business.

Full details of the steps that a UK VAT registered person needs to make to determine whether their customer is a relevant business person are contained in Notice 741A, section 6.

Some recipients of a service may have non-business activities (such as charities or local government bodies) but these are still treated as B2B supplies where the customer meets the above conditions, even if the service relates to their non-business activities.

VATPOSS01350

4.2.3 Article

In an article in *Taxation*, Neil Warren describes two problems relating to a UK business supplying services that are outside the scope, using a UK subcontractor. This situation led to two separate disputes with HMRC:

- one officer argued that the subcontractor was "really" supplying the services directly to the foreign customer, so the supply was outside the scope of VAT and the main contractor could not claim input tax;
- another officer sought to disallow input tax where the subcontractor's fees were recharged at cost, arguing that no supply was being made.

Warren explains why each officer was wrong and why they may have fallen into such mistakes (inexperience, homeworking), and how both issues were resolved satisfactorily – one officer accepted that the original view was wrong, but the other required a statutory review to correct the mistake.

Taxation, 27 January 2022

4.3 International supplies of goods

4.3.1 EU-UK trade committee

The European Commission has published the minutes of the first meeting of the Trade Specialised Committee on VAT Administrative Cooperation and Recovery of Taxes, which has been established under the EU-UK Trade and Cooperation Agreement. The subjects discussed relate to cooperation between the revenue authorities after Brexit.

https://ec.europa.eu/info/publications/first-meeting-trade-specialised-committee-vat-administrative-cooperation-and-recovery-taxes_en

4.3.2 Regulations

The *Value Added Tax (Enforcement Related to Distance Selling and Miscellaneous Amendments) Regulations 2022* correct a number of minor errors in the One Stop Shop and Import One Stop Shop legislation. The explanatory notes to the Statutory Instrument set out the purpose of the numerous technical amendments to the VAT Act and VAT Regulations in relation to UK persons registered for OSS and IOSS.

SI 2022/226

4.3.3 Updated guidance

HMRC have updated their guidance on the Union One Stop Shop VAT Return, which applies to Northern Ireland registered traders who make distance sales of goods to customers in the EU. They have added a new section "What not to include in your OSS VAT Return" which explains that businesses must not include any distance sales of goods that are zero-rated or exempt from VAT on the Union OSS VAT return. These sales should be reported in box 6 of their UK VAT return. Supplies of digital

services to EU consumers should also be excluded from the Union OSS VAT return.

The guidance is not particularly clear, in that presumably the goods should be included if they are taxable in the destination country – the reference to zero-rated goods may mislead traders into applying the UK rules.

https://www.gov.uk/guidance/completing-a-one-stop-shop-vat-return#what-not-to-include-in-your-oss-vat-return

4.3.4 Withdrawal of CHIEF system

HMRC have published a letter sent to all traders about the development of a replacement for Customs Handling or Import and Export Freight (CHIEF), which is nearly 30 years old. The new Customs Declaration Service is intended to be developed and fully operational by 2025.

The CHIEF system will close in two phases:

- Phase one: After 30 September 2022 the ability to make import declarations will end
- Phase two: After 31 March 2023 the ability to make export declarations will end

The Customs Declaration Service will serve as the UK's single customs platform, with all businesses needing to declare all imported and exported goods through the Customs Declaration Service after 31 March 2023.

The letter includes some advice on preparing for the changes.

https://www.gov.uk/government/publications/letters-to-businesses-about-importing-and-exporting-goods-between-great-britain-and-the-eu

4.3.5 Postponed accounting and the FRS

HMRC have published a Brief to explain a change to the way businesses registered under the Flat Rate Scheme should operated postponed accounting for imports from 1 June 2022.

Businesses using "normal VAT accounting" will declare import VAT in Box 1 of their VAT returns and (usually) recover the same amount in Box 4 as input tax. For VAT return periods beginning before 1 June 2022, FRS traders are supposed to include the value of imports in turnover for the flat rate calculation. They will therefore account for their FRS percentage of the import value, rather than 20%, and they will not recover anything in Box 4.

For return periods beginning on or after 1 June 2022, FRS businesses are required to exclude imports from the flat rate calculation, which will only apply to supplies made by the business. A separate calculation of import VAT must be carried out and the appropriate amount (generally 20%) will be added to Box 1. Presumably this will be recoverable in Box 4 if, and only if, it relates to an import of capital goods costing over £2,000 for use in the business.

HMRC will not collect any amounts that might have been due if the correct treatment had been in place for periods starting before 1 June

2022, and businesses will not be penalised in relation to those amounts. There is no need to amend returns that have already been filed.

The relevant guidance and Notices have been updated to reflect this change.

Revenue & Customs Brief 3/2022

4.3.6 Personal imports

Another case has come before the FTT on HMRC's refusal to allow Transfer of Residency Relief where someone has moved their personal possessions to the UK after the end of the Brexit transitional period (as in TC08333 *Brooks*). In this case, the appellants had moved to Spain in 2004 and decided to move back in May 2019. At that time, they did not have permanent accommodation, so they left their possessions in storage. The pandemic caused further delays during 2020, with the result that they were able to move into a new home in January 2021 and arrange for the transportation of their possessions at that time.

Judge Jane Bailey set out the statutory conditions for transfer of residency relief and pointed out that the only one that was not met was the requirement that the goods should be transferred within 6 months before and 12 months after the person takes up residence in the UK. She went on to consider the possibility of an "exceptional" waiver of the conditions. There was nothing significant that could distinguish their case from that of Mr Brooks. They had simply failed to appreciate the consequences of Brexit; if they had done so, they could have arranged for the goods to be transported earlier and put in storage in the UK. That was not enough to warrant an exceptional waiver. The appeal was dismissed.

First-Tier Tribunal (TC08416): *Adrian Ball*

4.4 European rules

4.4.1 Article

In an article in *Taxation*, Alex Baulf discusses the Commission's consultation document *VAT in the Digital Age* (tinyurl.com/3zhhsapz) and the proposals for a single VAT return for all EU transactions of non-established businesses. He notes that only about 7,500 businesses have registered with the Import One Stop Shop, far fewer than estimates of those likely to be required to register, and notes the possibility of regulatory penalties for those who are not complying with their present obligations, as well as outlining some of the possible future developments in this area.

Taxation, 17 March 2022

4.4.2 VAT waiver for joint defence spending

The Commission plans to incentivise Member States' investments in the European Defence Fund by proposing a VAT waiver for joint procurement projects. Under these plans, defence projects that involve more than one Member State will be significantly cheaper than if they

were conducted alone. The Commission will introduce this VAT waiver in a manner which remains compliant with World Trade Organization rules. At present only 11% of defence projects are done jointly, whereas the target set by Member States is 35%.

https://ec.europa.eu/commission/presscorner/detail/en/IP_22_924

4.4.3 Fiscal neutrality

A German trader supplied wood chips used for fuel. These were either "industrial wood chips" (made by cutting up logs) or "forest wood chips" (a by-product of forest maintenance). It charged the standard rate of VAT, because it had received a ruling that wood chips were not listed in the German law permitting the reduced rate for certain types of fuel.

It appealed the ruling, and succeeded in relation to supplies of wood chips on their own; however, a combined supply of wood chips and the service of maintaining cleaning a heating installation was confirmed by the court as standard rated, being a single combined service.

On a further appeal, questions were referred to the CJEU. Art.122 PVD states that "wood for use as firewood" may be reduced rated. Art.98 PVD allows for a reduced rate to be applied to categories of supply listed in Annex III, and allows member states to more closely define the categories eligible by using the Combined Nomenclature. Wood chips can be distinguished from logs and other firewood using the CN, but the referring court was not sure whether such a distinction was allowed if a member state had used the derogation in art.122. There was also a question of whether fiscal neutrality required the same rate to be charged.

The court ruled that art.122 must encompass any wood that is used for burning. It had to be an independent concept of EU law that would be applied in the same way everywhere. However, even if there was no reference to the CN in art.122, it was settled case law that member states were entitled to more precisely define the scope of reduced rated supplies, provided they could do so in a manner consistent with the principle of fiscal neutrality. This required consideration of whether wood chips were interchangeable, from the point of view of the average consumer, with other forms of wood for burning. This would be for the referring court to ascertain, However, as wood chips tend to be burned in specific appliances for the purpose, they probably are not so interchangeable with logs.

CJEU (Case C-515/20): *B AG v Finanzamt A*

4.4.4 Guarantee work

Suzlon Wind Energy Portugal (SWEP) is a company operating in the energy industry sector, particularly in the wind energy sector. Its activity is manufacturing, assembly, operation, marketing, installation, development, machining, implementation and maintenance, as well as the provision of services. It is registered for VAT in Portugal. It is a 100% owned subsidiary of Suzlon Wind Energy A/S, established in Denmark (SWED); SWED was a wholly owned subsidiary of an Indian company, Suzlon Energy Ltd (SEL).

In 2006 SEL entered into a contract to supply wind turbines to SWED. The parts were subject to a two year warranty against manufacturing

defects. In 2007 and 2008, SWEP acquired directly from SEL a set of 21 wind turbines for operation in Portugal. From 2007 onwards, cracks appeared in some of the turbine blades while they were still within the warranty period.

In January 2008, SWEP and SEL entered into an agreement whereby SWEP would establish a repair unit for wind turbines in Portugal, and 63 replacement blades would be transported from India to Portugal. SEL agreed to provide logistical support to SWEP to assist it in repair operations; SWEP agreed to provide SEL with various services associated with the repairs under warranty. It also had to acquire, on behalf of SEL, all the equipment and materials needed to repair the defective blades, and to organise the internal transport of the replacement blades. This contract characterised the relationship between the parties as customer and supplier, with SEL acting on its own behalf rather than in the interest of SWEP.

Between September 2007 and March 2009, SWEP carried out the repairs, incurring expenditure and deducting the VAT on that expenditure. In February to March 2009, SWEP issued three debit notes to SEL for about €8 million, none of them mentioning VAT or giving any reason for not charging VAT. In May 2012, the Portuguese tax authority issued an assessment on SWEP for an amount representing the VAT on those debit notes.

SWEP appealed, arguing that it was simply recharging expenses incurred on SEL's behalf, and it had not intended to earn income. The debit notes did not represent consideration for a supply, but reimbursement for costs incurred in carrying out an obligation of SEL. The tax authority maintained that SWEP had carried out a service in Portugal, and this should have been subject to VAT at the standard rate. Questions were referred to the CJEU.

There were some legal arguments about the admissibility of the questions, and the court noted that they appeared to consider the relevant law to be the Sixth Direction even though that had been replaced by the time of the issue of the debit notes. Nevertheless, it was possible to answer the questions as there had been no substantive change to the provisions when the Directive was recast into the PVD.

The court started by noting the five conditions for VAT to be chargeable under PVD art.2(1)(c): the transaction in question constitutes a supply of services, that it is carried out for consideration, that it takes place on the territory of a Member State, that it is the made by a taxable person and that the latter acts as such. It was clear that SWEP was a taxable person and the transactions were carried out in Portugal, so two of these criteria were satisfied.

The question of whether SWEP was acting "as such" involved verifying whether it was acting in its own name in relation to the transactions represented by the debit notes. It would be for the referring court to examine the contractual and accounting framework, in particular to consider the possible existence of suspense accounts within the meaning of PVD art.79(c).

The sale of the original turbine blades by SEL to SWED and its subsidiaries came with the benefit of the warranty. It did not appear that

SEL had given any warranty to anyone to whom SWED and SWEP might sell on the equipment. That appeared to be entirely separate from SWEP's activities in carrying out the repairs, which were subject to a contract between SWEP and SEL. The way in which the 2008 contract was drawn up and the way in which SWEP acted in relation to it were strongly indicative of a taxable person acting as such. The contract was clearly one for the supply of services.

The remaining question was whether the supply was carried out for consideration. The argument that SWEP did not intend to make a profit carried no weight: charging for a service at above or below cost did not affect the liability to VAT, as long as the conditions for "a supply for consideration" were met. In this case, there was a legal relationship between the parties and reciprocal performance.

The fact that the work was carried out under guarantee would only make a difference if it affected one of the criteria listed above. In addition, the service under SWEP's contract was more involved than simply replacing defective parts: SWEP had carried out work to identify defects and had reported on them to SEL over an extended period.

The overall answer was that the transactions in this case constituted a supply of services for consideration. Note that under the present place of supply rules, this would be a B2B supply that would be chargeable where the recipient belongs (i.e. India); however, before 1 January 2010 "work on goods" was carried out where the work was physically performed, subject to exemptions when the goods then left the territory.

CJEU (Case C-605/20): *Suzlon Wind Energy Portugal – Energia Eolica Unipessoal Lda v Autoridade Tributaria e Aduaneira*

4.4.5 Procedures during dispute

A Romanian road construction company was subject to a tax audit for the period January 2011 to April 2014. This confirmed the deductibility of VAT on transactions recorded in the accounts. Subsequently the public prosecutor brought an action for fraud against various people, including the manager of the company, and asked the tax office to carry out a fresh check. This was done in October 2016, and concluded that the company was not entitled to deduct VAT on a number of transactions. An assessment for approximately €425,000 was raised to disallow the input tax (as well as corporation tax).

The dispute that resulted in a reference to the CJEU is about the interaction between a criminal prosecution and determination of a VAT assessment, and appears largely to concern the procedure for assessing and disputing an assessment, the rights of the tax authority to obtain information from a parallel criminal investigation, and the rights of the taxpayer to suspend payment of the VAT during the extended investigation and to receive compensation if it eventually found that it had been incorrectly denied a deduction.

In essence, it appears that the CJEU does not regard the Romanian law as contrary to the Directive, provided that there is scope for compensating the taxpayer if the assessment eventually proves to be unfounded.

CJEU (Case C-582/20): *SC Cridar Cons SRL v Administraţia Judeţeană a Finanţelor Publice Cluj and another*

4.4.6 Repayment of disputed tax

Another case referred by Romania related to demands for tax in 2016, partially settled by the taxpayer, and the obligations and rights of a taxpayer while disputing the balance. The company sought repayment of VAT after a court found in its favour, but it appears that the Romanian authorities ruled that the credit should be carried forward and offset against later liabilities. The CJEU considered that this contravened the principle of equivalence, in that the Romanian rules on VAT appeals were less favourable than those applicable to domestic taxes and duties other than VAT.

CJEU (Case C-487/20): *Philips Orăştie SRL v Direcţia Generală de Administrare a Marilor Contribuabili*

4.4.7 Flat rate scheme

Poland operates a flat rate scheme for farmers in accordance with art.296 PVD. A Polish husband and wife were both registered as flat rate farmers up to the end of 2010; the wife then sought to register for VAT under the normal rules, while her husband continued to be a flat rate farmer. A dispute arose after she claimed to have overpaid tax; the authorities ruled that because that the agricultural operation (raising broiler chickens) took place on jointly-owned land, it was not possible under Polish law for one spouse to be a flat rate farmer and the other to be an ordinary taxable person. In effect, by registering for the normal rules, she had also registered her husband. She appealed, arguing that the operations were carried on in separate poultry houses, and questions were eventually referred to the CJEU.

The court considered the concept of "independent activity" within art.9 PVD, and decided that it was not permissible for a member state to have a general rule that regarded the operations of spouses as interlinked in this way. The purpose of the rule was to prevent evasion, avoidance or abuse, but the way it operated amounted to a general assumption that these problems would arise. The state should consider evidence presented by the taxpayers to show that their operations were carried on independently; the fact that they were on jointly owned land was not relevant.

On the other hand, the flat rate scheme was specifically intended to relieve the difficulties that farmers might have in operating under the normal rules. It would be open to a member state to consider, on particular facts, whether an applicant for flat rate status would have problems complying with the normal rules. If that was the case, flat rate registration could be refused. The implication is that the wife's ability to operate under the normal rules would indicate that the husband could also do so.

CJEU (Case C-697/20): *W.G v Dyrektor Izby Skarbowej w L*

4.4.8 Legal formalities and option to tax

Lithuania only allowed transactions to be subject to an option to tax if the recipient of the supply was a taxable person, and that person had been registered. In a case referred to the CJEU, the registration could not be completed until a month after the supply; this meant that the option was ineffective and input tax had to be adjusted. A-G Kokott has given an

opinion on whether the requirement for the formalities to be completed was in accordance with the PVD.

The appellant argued that the Lithuanian law, in requiring not only that the recipient should be a taxable person but that they should have a VAT identification number at the time of the supply, was a breach of the principle of fiscal neutrality.

The A-G considered in detail the purpose of the option to tax and the reasons for the Lithuanian restrictions, and concluded that the rules did not breach the principle of neutrality, nor were they disproportionate in their effect. The fact that the recipient of the supply was identified for VAT a mere month after the supply was irrelevant.

CJEU (A-G) (Case C-56/21): *UAB "ARVI" ir ko v Valstybinė mokesčių inspekcija pray Lietuvos Respublikos finansų ministerijos*

4.5 Foreign refund reclaims

Nothing to report.

5. INPUTS

5.1 Economic activity

5.1.1 Holding company activity

Advocate-General Pitruzzella has given an opinion in a case about a holding company referred from Germany. He notes that there are no specific provisions in EU law about holding companies, so the principles applicable to them have been developed in a number of case law decisions. In particular, there is a distinction between a "pure holding company", which simply acquires and holds shares and exercises its shareholder rights, and a "mixed holding company", which also has its own economic activity. The subject is complicated by the multiplicity and complexity of factual situations and the difficulty of linking them to a unitary system.

W was a German holding company with subsidiaries X and Y, to which it supplied administrative and accounting services for consideration. The German authorities questioned W's right to deduct input tax when most of the activities of X and Y were exempt. If the right existed in principle, the court was asked to rule on whether it might be abusive.

All three companies operated in real estate and construction. X and Y were involved in housing projects, for the most part within an exemption regime. In 2013, X was owned 94% by W and 6% by another company, Z. Z agreed to make a contribution of €600,000 to the capital of X, while W agreed to provide services valued at €9.4 million free of charge in connection with two construction projects. These included planning services for energy supply, thermal insulation and network connections, architectural services, general contracting services, development and marketing. Under a separate contract, W agreed to provide, for consideration, accounting and management services to X, in connection with those construction projects. These services included the recruitment and dismissal of staff, the purchase of equipment, the preparation of annual accounts and tax declarations and their communication to the tax authorities. These services were expressly excluded from the services that the applicant had to perform as a contribution as a partner. A similar arrangement was entered into in relation to Y, which was owned 89.64% by W and 10.36% by another company, PI.

In its tax returns for 2013, W deducted all the input tax incurred by it in relation to its transactions. Following a tax audit, the tax authority concluded that the partner contributions for X and Y should be classified as non-economic activities, as they had not generated any revenue within the meaning of the turnover tax legislation; the input tax attributable to those activities should therefore not be deductible. In 2018, an appeal court upheld the company's case, ruling that it was entitled to deduct all of the input tax, because it was involved in the management of the subsidiaries and made no exempt supplies. On appeal by the tax authority, the higher court decided to refer questions to the CJEU.

The referring court was concerned that the inputs that related to the partner contributions were not truly overheads of the holding company because they did not benefit its economic activity but rather that of the subsidiaries; they were not directly attributable to the supplies that it made

for consideration. If the input tax was deductible in principle, a further question asked whether the arrangement was abusive.

W argued that there were non-tax reasons for the way the operations had been set up. These included protection of W from liabilities in relation to decontamination of sites selected for construction, and from claims by creditors if the projects resulted in insolvencies. The provision of services in kind achieved economies and efficiencies, and preserved confidentiality of profit margins from competitors and the other parties to the project. The arrangement was therefore not abusive because it was not set up with the sole or main aim of achieving a tax advantage; full input tax deduction was therefore due in accordance with previous cases about holding companies.

The German government and the Commission argued that the costs incurred in the partnership activities were neither direct costs nor general overheads of the holding company's economic activity. As they were used to carry out downstream activities that were exempt, no right of deduction should exist. The German government also argued that there was abuse, although the Commission considered that it was not necessary to answer that question (presumably because it considered that the right to deduct did not exist in principle).

The A-G considered the precedent cases that have established the conditions for a holding company to deduct input tax. This review included the distinction between a pure "investment holding company" and a "management holding company"; it was clear that W was a management holding company and a taxable person.

The next question was whether there was a link between the inputs and the claimant's taxed transactions. This required them to be directly linked, or else general costs. The A-G considered that this condition was not satisfied in the circumstances of the case. The partnership contributions were not intended to generate any income. It was clear that they were directly linked to downstream transactions of the subsidiaries (which were exempt), and could not therefore be directly linked to any outputs of W.

The A-G saw a clear distinction between this situation and precedent cases on what constitutes "general expenses" of holding companies – usually costs associated with acquiring subsidiaries. Although there was no clear definition of "general expenses", the link between the "in kind" contributions and the benefit to the subsidiaries was different from the link between acquisition costs and the benefit to the acquiring holding company.

This meant that it was not necessary to answer the question about abuse, but the A-G added some observations in case the court came to a different conclusion on the first question. It would be for the national court to determine whether there was objective evidence that the transactions were entered into with the sole or main purpose of achieving a tax advantage that was contrary to the purpose of the Directive. The A-G considered that the recovery of VAT by W in the present circumstances was contrary to the aims of the Directive, and various different ways of setting up the arrangements would not have achieved the advantage that W argued for; it did therefore appear to be an abusive arrangement.

There was also a subjective element in a finding of abuse: the purpose of the arrangement had to be to obtain the advantage. W had put forward various non-tax justifications for what it had done. This would have to be taken into account by the national court, but such a non-tax justification could not, in the A-G's opinion, override the clear objective result of the arrangement, which was that it did achieve an unfair tax advantage. He suggested that the answer to the second question was that such an arrangement would be abusive.

CJEU (A-G) (Case C-98/21): *Finanzamt R v W-GmbH*

5.2 Who receives the supply?

5.2.1 Indirect mail

In TC07777, the FTT considered the case of a company that arranged for the importation of goods owned by companies in China and Hong Kong. It collected them from the airport, stored them if required, sorted them and arranged delivery of the goods to the final customer. It had formerly acted as a fulfilment house, but was no longer registered as such under the Due Diligence Scheme. The company used delivery companies including UPS, DPD, Yodel and Royal Mail to carry out the physical movement of goods.

Royal Mail suspended supplies to the company because it was not satisfied with the reporting of usage of its services; a legal action followed, at the end of which the company paid £600,000 to Royal Mail. Arrangements were entered into with an individual and another company for them to operate accounts with Royal Mail, apparently hiding the identity of the true customer, while the company's account was suspended.

The company also used Yodel, but many of the invoices from Yodel were addressed to another company with which the appellant had carried on a joint venture, 4PX Ltd. HMRC ruled that the company had not received the services from Royal Mail or Yodel and was therefore not entitled to input tax deduction. The tax in dispute was over £460,000, and a penalty was charged of £267,000.

HMRC argued that the intermediaries who stood between the company and Royal Mail were not in business, but nevertheless received the supplies from Royal Mail. They could not make taxable supplies to the appellant, nor issue a valid tax invoice.

The company's representative argued that, in accordance with the economic and commercial realities of the situation, the intermediaries were supplying the facilities of their Royal Mail accounts to the appellant. It was submitted that valid VAT invoices had been provided, and if they had not, HMRC's refusal to accept alternative evidence was unreasonable.

The Tribunal examined the relationship between the company and one of the intermediaries, Colemead Ltd. The sole director of that company appeared to have no knowledge of how it operated, and was paid a trivial and irregular amount of money for what he did. The input tax claimed of

£208,829 on "supplies" by Colemead was disallowed on the basis of cases including *Longridge*, *Wakefield College* and *Finland* – the company was not in business.

A similar decision was reached in relation to the individual intermediary, Mr Man, and another £173,257 of input tax.

The explanations for the incorrect addressing of the Yodel invoices were not accepted, denying a further £81,028 of input tax. The company had not shown that it had received the supplies rather than the other company.

The disclosures were accepted to be "prompted". HMRC charged penalties on the intermediary disallowances on the "deliberate and concealed" scale with an 80% reduction for helping, giving access and telling. The Tribunal decided that the circumstances warranted a "careless" penalty instead, with the same reduction, and reduced the charge from £229,143 to £68,743.

The Yodel disallowance had been charged as "prompted, deliberate but not concealed" with 65% reduction for helping and giving access. Again, the Tribunal reduced the scale to "careless" and the amount from £38,285 to £16,408.

The FTT dismissed the appeal in relation to the input tax claims, and allowed it in part in relation to the penalties. The company appealed to the Upper Tribunal, arguing that the FTT had erred in law in concluding that the company had not received taxable supplies of delivery services from the intermediaries who stood between it and Royal Mail, or in the alternative, in finding that it had not received Royal Mail's supplies directly.

The UT (Judge Jonathan Richards and Judge Andrew Scott) examined the basis of the FTT decision that the intermediaries were not carrying on an economic activity, and the appellant's criticisms of it. The FTT had properly considered whether the relationship between the parties, the services and the payments met the conditions for "supplies for consideration in the course of an economic activity", and had justifiably concluded that they did not.

As regards the alternative ground of appeal, the appellant would have to show that the "economic reality" was that Royal Mail was making its supplies directly to the company. Given that the whole reason for the arrangements was that Royal Mail was not prepared to do this, the argument could not succeed. Royal Mail could not have known that the appellant was the actual user of the services.

The appeal was dismissed again.

Upper Tribunal: *Y4 Express Ltd v HMRC*

5.2.2 Updated Manual

New content has been added to the VAT *Input Tax Manual* to clarify the issues arising in connection with input tax claims by toll operators (UK businesses that typically import and use equipment to manufacture goods for a foreign customer, where the customer continues to own the equipment).

VIT44400

5.3 Partial exemption

5.3.1 Updated Manuals

Further information has been added to the VAT *Partial Exemption Guidance Manual* in relation to the effect on partial exemption of moving goods from Northern Ireland to Great Britain.

PE68100–PE68400

The VAT *Input Tax Manual* has been updated to include the minimum values of items to be classified as “capital items” and to include computers in the list of such items.

VIT25000

5.4 Cars

5.4.1 Charging electric cars

Following the controversial statement about the VAT treatment of charging electric cars in Revenue & Customs Brief 7/2021, HMRC have announced a review of the policy. The review will focus on two areas:

- evidence that will be required to enable an employer to claim the related VAT, where the employer reimburses an employee for the actual cost of electricity used in charging an electric vehicle for business purposes, and
- potential simplification measures to reduce the administrative burdens of accounting for VAT on private use.

HMRC have also added a new section 8 to Notice 700/64 *Motoring Expenses* covering recovery of input tax incurred by businesses in relation to the charging of electric cars. The Notice confirms HMRC’s intention to review the above two points.

Revenue & Customs Brief 1/2022

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 Withdrawal of relief

In TC07010, a factoring company appealed against assessments withdrawing bad debt relief it had claimed in its returns for periods between July 2007 and January 2010. The chief executive explained the way in which the business operated, giving an example in which a customer (also called a "supplier" – the source of the debts) factored an invoice worth £1,000. The appellant would advance £764, being 80% of the debt, less its charge of £30 plus VAT; when the debt was collected, the remaining £200 would be paid over to the customer (or would be credited to its account, as the funding of customers was an ongoing process).

The factoring was "with recourse", which meant that the customer/supplier was required to "buy back" the debt if the appellant was unable to collect it. It was therefore possible that a customer/supplier would have received advances that were not covered by receipts; if it could not repay these, the company appeared to have a bad debt. The question for the Tribunal was whether all debit balances written off were bad debts qualifying for VAT relief.

HMRC argued that the fee for the factoring service was deducted when the appellant made its initial advance of funds to the customer/supplier (the £36 held back out of £800 in the above example). There was therefore never a debt that was unpaid in respect of the supply. If there was in the end an irrecoverable balance, it arose because the factored debt was irrecoverable and the customer/supplier was unable to refund the advance. That was a bad debt on lending, rather than a bad debt in respect of the consideration for the company's supplies.

There was a further argument that the contract provided that charges became due and payable "forthwith" on entering into a factoring agreement. In many cases, the claim to bad debt relief was made a long time after the initial advance, and HMRC therefore argued that it would be made outside the time limit (up to 31 March 2009, this was three years and six months from the date the debt was due).

The company argued that, at the time of making the advance, the only movement of funds was from it to the customer/supplier. There was no consideration moving the other way at that time. Although the contract referred to the charges being due and payable on entering an agreement, according to the conduct of the parties the charges were only due once collection of the debt had proved impossible and recourse was taken to the customer/supplier.

There was a further dispute about whether the company's records satisfied the requirements for a "bad debts written off" account in SI 1995/2518 reg.168.

The FTT judge based his decision on interpretation of a 2002 contract that had been in force at the relevant times, even though much of the enquiry and dispute had focussed on a 2011 version. The terms of that contract appeared clear and consistent: "an Initial Advance will made against such debt less any … fee whatever payable to the factor by the Supplier according to the terms of this agreement". The contract provided that it

could not be varied without formal agreement, so the "conduct of the parties" argument failed.

The judge also held that the company's bad debt accounting, which failed to establish a clear audit trail identifying which invoices had been claimed for, did not meet the requirements of the regulations. Even if the company had succeeded on the issue of consideration received, it would have failed on its record-keeping.

The appeal was dismissed, and the company appealed to the Upper Tribunal, coming before Mrs Justice Bacon and Judge Jonathan Cannan. The decision starts by emphasising that the issues to be determined were the identification of the taxable amount of the company's supplies, the time when that taxable amount was paid and the circumstances in which it could be reduced after a supply has been taken place, in accordance with art.73 and art.90 PVD, s.36 VATA 1994 and the regulations made under it regs 165A to 172 SI 1995/2518.

The grounds of appeal were that:

(1) The FTT erred in its interpretation of the contractual arrangements.

(2) The FTT erroneously disregarded the economic reality.

(3) The FTT's reasoning does not apply to all of the disputed claims, including in particular charges or disbursements which arise after the Initial Advance and any charge payable by a client to whom no advances have been made.

(4) The FTT misinterpreted the requirements of the Regulations.

In response to grounds (1) and (2), the judges decided that the FTT had been wrong to hold that the company had received its consideration at the time it made the initial advance. The reasoning is complicated, but it appears that the offset at that point did not constitute "payment"; the company could only collect the fees due when it had received more money from the customer than it had advanced. The judge illustrated the point by supposing a single advance where nothing was subsequently received: clearly the company would not have been paid the consideration for its service, and would be entitled to a bad debt claim.

The fact that a running account was maintained for continuing customers made it difficult to identify particular supplies for this purpose, although the company conceded that it was possible; the accounting system was relevant to determining the entitlement to a claim in accordance with the regulations, but as a matter of contract, the fee was not "paid" at the outset.

The judges were not satisfied that the FTT had made an error of law in approaching the issue of charges and disbursements (ground (3)). However, in line with the decision on ground (1), the company did not recoup these amounts until it had made a recovery of the underlying debt.

Turning to ground (4), the judge noted that the company's representative pointed out that HMRC had failed to utilise the procedure in reg.171(3) to recover relief that had been claimed and paid in breach of reg.168. However, this had not been argued by the company before the FTT, and was not among the permitted grounds of appeal. Nor had the company argued that HMRC should have exercised its discretion to allow the relief

even with a breach of reg.168. Instead, it argued that its accounting records satisfied all the requirements of reg.168(2); they were not prepared or designed for that purpose, which meant that reg.168(3) did not apply – it only required records to be kept in a single account if they were "created in pursuance of this regulation".

The company's representative argued that *Tratave* (Case C-672/17) was authority for the proposition that formalities should not prevent a taxpayer exercising the fundamental right to adjust the taxable amount where consideration was not received. He submitted that HMRC's requirement in reg.168 for a "single account" was a matter of their administrative convenience which was not a permissible purpose.

The UT did not agree. The purpose of reg.168 was plainly to establish an audit trail whereby HMRC could check a bad debt relief claim. The company had clearly not done that, and the FTT had been entitled to conclude that it had not done so. The *Tratave* decision related to national laws that made the claiming of a relief practically impossible or excessively difficult. Requiring an audit trail did not clear that hurdle: it was plainly within the margin of discretion allowable to Member States.

The UT concluded that "the fact that Regency did not keep a single refunds for bad debts account was simply a matter of administrative convenience for Regency. Regency is not being penalised for its business model, as suggested by Mr Ripley. It has been denied relief because of deficiencies in its record keeping."

The appeal was dismissed on ground (4) alone, and the company appealed further to the Court of Appeal. HMRC cross-appealed against the UT's decision that there was in fact a bad debt; because the CA decided to dismiss the company's appeal, it was not necessary to hear arguments about HMRC's cross-appeal, and no decision was issued in relation to it.

Lewison LJ analysed a number of CJEU precedents on the extent of member states' discretion to impose conditions on bad debt relief claims. In his view, even where national legislation pursues a legitimate objective (e.g. prevention of fraud or abuse) and is not excessively onerous, the member state concerned must still permit the taxable person to show that he is in fact entitled to bad debt relief; and that compliance with the particular formal requirement would have made no difference. Likewise, if a legitimate requirement is impossible or excessively difficult to comply with, a member state must allow the taxable person to prove their entitlement to bad debt relief by other means. The existence of particular formal requirements had not been held to be unlawful in itself, as long as member states recognised the supremacy of the substantive conditions (i.e. non-receipt of the consideration).

He went on to agree with the UT that the UK requirements were not unduly onerous, and had a legitimate objective. The company had not made out a case that the requirements made it impossible or excessively difficult to claim the relief. The requirement to maintain a single bad debts account in reg.168(3) was entirely justifiable to prevent avoidance and abuse, and was not simply an "administrative convenience for HMRC".

The FTT had found as a fact that the company's bad debts account contained an "admixture of funds" and that it was impossible to identify

particular credits with particular invoices. This meant that it was impossible for the company to show that the substantive conditions for BDR had been met. It had had the opportunity to prove its claim in the FTT and had failed to do so; it was not allowed a second opportunity in the upper courts.

The appeal was unanimously dismissed.

Court of Appeal: *Regency Factors plc v HMRC*

5.8 Other input tax problems

5.8.1 Missing traders

A company appealed against decisions to deny input tax totalling £19 million in periods from 06/15 to 03/16. The appellant accepted (as part of *Fairford* directions) that:

(1) The accuracy of each transaction chain as set out in the Respondents' witness evidence;

(2) That there is a tax loss at the start of each transaction chain; and

(3) That the tax losses are attributable to the fraudulent evasion of VAT.

The focus of the Tribunal was therefore on the question of knowledge or means of knowledge. Judge Malek examined the arguments put forward by HMRC and the defences put forward by the appellant, and concluded that there was not compelling evidence that the trader knew, or had the means of knowing, that the transactions were connected with fraud. It was true that the trader was aware of the risk of fraud, and the unusual financing arrangements in these deals should have put them in a heightened state of awareness of the risk; the due diligence exercise was not adequate, but that could be explained by the fact that the business was going through a restructuring exercise, and the inadequacy looked worse with "20-20 hindsight". The judge did not accept that the only reasonable explanation for all the circumstances was a connection with fraud; the appeal was allowed.

First-Tier Tribunal (TC08373): *PTGI-ICS Ltd*

A company appealed against decisions dated 8 August 2007 and 31 October 2008 to deny input tax reclaims totalling over £4 million in respect of 17 transactions in electronic goods and software in periods 02/06 and 05/06 on *Kittel* grounds. There were also two disputed transactions (Apple iPods) in 08/06 with a VAT value of £611,000. The company disputed all aspects of HMRC's case, including knowledge, means of knowledge and connection to fraud (which was alleged to be both direct and by contra-trading).

The decision started with a review of the long and involved procedural history, which included several "unless orders" issued to the company, *Fairford* directions and a number of other case management issues. The company had been reminded that disputing the entirety of HMRC's evidence might be found to be unreasonable conduct, and it was encouraged to identify specific matters which were to be challenged.

The judge (Tracey Bowler) set out the long list of the company's grounds of appeal; the original 11 grounds had been filed in 2007 and 2008 before most of the case law on the subject, but there were a further 25 grounds identified (some with subheadings) before the hearing itself in 2021. There were then a number of procedural points, including the refusal of various applications by the company to have some of HMRC's evidence struck out, difficulties with the remote hearing (the appellant was in South Africa) and other applications about admission of further evidence.

The "substantive decision" begins on page 19. After another three pages setting out terminology from precedents, including contra-trading, the key questions were listed:

(1) Was there a tax loss?

(2) If so, did this loss result from a fraudulent evasion?

(3) If there was a fraudulent evasion, were the Appellant's transactions which are the subject of this appeal connected with that evasion?

(4) If such a connection was established, did Tradestar know or should it have known that its transactions were connected with a fraudulent evasion of VAT?

In relation to the deals involving contra traders, HMRC must also prove that the contra-traders were parties to conspiracies involving the defaulters in their transaction chains.

The judge dismissed the appellant's claim that there should be a higher civil standard of proof in respect of the allegations of fraud. There was only one civil standard. The appellant was also mistaken in arguing that he had been given insufficient information to be able to prove whether there was a tax loss: as had been explained to him in numerous hearings over the years, it was for HMRC to prove a tax loss, not for him.

The company had originally required 19 of HMRC's 25 witnesses to attend the hearing. This was reduced to 8 by the time of the hearing; in the event, the appellant (the sole director/shareholder who represented his own company, because of lack of funds) only cross-examined two of them. It was explained to him that failing to take issue with a witness's evidence meant that it would be given full weight as undisputed.

The judge was then finally able to consider the history of the company and its dealings in detail. She concluded that all of the disputed deals could be traced to a fraudulent VAT loss, whether directly or via a contra-trader. Further, the director had been warned about MTIC fraud and sent a copy of Notice 726; however, he only carried out very limited checks, and none before 27 April 2006. The due diligence appeared not to have been undertaken at the same time as the deals, and no explanation for the discrepancy was provided.

All of the evidence pointed to the dealing being contrived and artificial. The basis for the decision was set out in great detail (the decision runs to 635 paragraphs with three appendices); the judge was satisfied that the director actually knew of the connection to fraud, and dismissed the appeal.

The appeals had been going on for so long that there was a further question about the applicable costs regime. The judge decided that an

order in 2012, that costs should be determined in accordance with the 1986 Tribunals Rules, had not been disputed at the time by the company, and could not be disputed now. HMRC could apply for their costs within 56 days of the decision.

First-Tier Tribunal (TC08361): *Tradestar International Ltd*

5.8.2 Connected companies and non-payment of VAT

A long-established construction company appealed against refusal of input tax credit of £268,000 on supplies received from an associated company in the periods from 06/17 to 12/17. The associated company had provided management services; it never accounted to HMRC for output tax on its supplies, and was put into liquidation after only a year of operation. HMRC's decision was based on a connection with fraudulent evasion of VAT; the FTT considered that the key issue was whether the directors had been dishonest.

The company argued that the associated company had been set up for proper commercial purposes and not fraudulent or abusive ones. The liquidation of that company had been due to commercial problems, not fraud. The burden of proof lay on HMRC to show dishonesty, but the normal "balance of probabilities" test applied.

Judge Tracey Bowler started by discussing her impressions of the reliability of the witnesses. One of the company's directors could not remember many details, and another diverged considerably from his written witness statement when giving oral evidence and under cross-examination. The judge stated that she would reduce the weight given to their evidence accordingly, and would prefer other evidence where it contradicted what they had said.

The history of the business was set out in detail. The associated company had been established to pay sub-contractors in the construction business, and was said to be intended to protect the group from claims that the sub-contractors were employees. During its lifetime it had turnover of £1.6 million and finished up owing trade creditors only £1,684; however, it owed HMRC £318,755, made up of VAT, PAYE and Construction Industry Scheme deductions. It was owed £280,723 by the appellant. The liquidators decided not to apply for winding-up of the appellant apparently because they realised there was a close connection between the money they owed to HMRC and the money owed to them by the appellant; they would not pursue the debt until the dispute with HMRC was resolved.

After lengthy discussion of the facts and a number of legal precedents, the judge commented that it was clear that there was no co-ordinated plan to avoid VAT. However, it was also clear that those running the businesses prioritised the payment of other creditors over HMRC. VAT returns were submitted claiming VAT that the directors knew would not be paid to HMRC by the associated company within a reasonable period; in effect, the claims were a form of loan application, but one that the lender (HMRC) had not been asked to approve. The failure to be open and honest with HMRC about the financial difficulties amounted to dishonesty under the relevant legal tests.

Thea appeal was dismissed.

First-Tier Tribunal (TC08429): *Grantham Ceilings & Interiors Ltd*

5.8.3 Updated Manuals

A section has been added to the VAT *Input Tax Manual* to clarify what a supplier should do to enable a recipient to claim input tax where a supply of goods was made for no consideration (i.e. a gift) and the recipient uses the goods for business purposes. Where the supplier is required to account for output tax under VATA 1994 Sch.4 para.5, the neutrality of the tax requires that a taxable person who uses the goods in the course of business should be entitled to recover that charge as input tax.

VIT12200

The term "acquisition" has been removed from the list of examples of event that can give rise to input tax entitlement, following Brexit.

VIT12500

The notes on input tax entitlement have been expanded to clarify that VAT on pre-registration expenditure can be claimed as input tax in certain circumstances.

VIT30500

6. ADMINISTRATION AND PENALTIES

6.1 Group registration

6.1.1 Eligibility conditions

HMRC issued decisions in December 2017 that removed five entities within the HSBC corporate group (referred to as "global services companies" or GSCs) with effect from 1 October 2013 or, alternatively, from 1 January 2018. The company appealed, and Judge Greg Sinfield ordered that some preliminary issues should be determined by the Upper Tribunal before the main appeal proceeded.

HMRC's primary case is that the GSCs have not been established in the UK, nor had a fixed establishment here, since at least 1 October 2013, and have therefore not been entitled to be members of a UK VAT group. The alternative case is that the GSCs should be removed with effect from 1 January 2018 in the exercise of HMRC's revenue protection powers.

The preliminary issues for determination were agreed between the parties as follows:

(1) How is the concept of two or more bodies corporate being "established" or having a "fixed establishment" in section 43A of VATA, which it is common ground purports to implement the words "any persons established in the territory of that Member State" in Article 11 of Council Directive 2006/11/EC (the Principal VAT Directive, or "PVD"), to be interpreted? (the "Section 43A Issue")

(2) Is the question of whether the UK discharged its obligation to consult the VAT Committee relevant? If it is relevant what would be consequences of any breach of the obligation to consult? (the "VAT Committee Issue")

(3) Are the measures which a Member State may adopt under the second paragraph of Article 11 of the PVD to prevent tax evasion or avoidance through the use of Article 11 limited to those needed to prevent tax evasion and avoidance caused by an abusive practice under Halifax1 principles, or any concept of avoidance arising from Direct Cosmetics Limited and Laughtons Photographs Limited v Customs and Excise Commissioners C-138 and C-139/86? (the "Abusive Practice Issue")

(4) Is section 84(4D) VATA engaged in relation to these appeals and, if so, what are the factors that the Tribunal must take into account in considering whether or not HMRC decided on an appropriate date? (the "Section 84(4D) Issue").

HMRC sought to add a further preliminary issue after the case had been transferred to the Upper Tribunal: whether the wording of VATA 1994 contains a territorial limitation such that a UK VAT group does not include establishments outside the UK. A judge refused the addition of this to the matters to be formally decided, but insofar as the case on which it was based (*Danske Bank* Case C-812/19) was relevant to the matters for determination, HMRC were free to make submissions on it.

It was agreed that the preliminary issues raised pure points of law, with exceptions noted in the decision. There was an agreed statements of facts

and issues which is included as an annex. The UT "set the scene" by noting:

(1) each of the GSCs is incorporated in one or other foreign jurisdiction;

(2) the GSCs were incorporated as part of a programme of relocating the provision of various functions and processes from the UK to offshore, lower cost jurisdictions;

(3) the GSCs provide services to and for the benefit of entities within the HSBC Group; and

(4) the GSCs have registered branches in the UK with Companies House under Part 34 of the Companies Act 2006 and the Overseas Companies Regulations 2009

However, the parties were not agreed about the extent of the functions that were in fact carried out by each of the GSCs.

The legal analysis is complicated, but the UT provided useful summaries of the respective positions. Central to HSBC's case was the proposition that PVD art.11 only contains one "substantive condition", that persons to be included in the VAT group are closely bound to each other by financial, economic and organisational links, and the reference to "persons established in the territory of that Member State" in art.11 did not refer to each group member individually but rather to the group collectively. This supported the contention that VATA 1994 s.43A went beyond what was permitted in requiring that each individual member of a group should have an establishment or fixed establishment in the UK.

The company also put forward alternative arguments if they lost on the "single substantive condition" point:

- to be established in the UK for this purpose, it was only necessary to have a physical presence through a branch, evidenced by registration of that branch under the Companies Acts;
- for the interpretation of the expression "fixed establishment" in s.43A, the definitions of that term in cases about place of supply should not be regarded as binding.

The UT discussed the *Marleasing* principle of "conforming construction" and the need to interpret and apply EU legal provisions in accordance with their purpose (the "teleological" approach). However, a "plain reading" of art.11 suggested that there were two conditions for the persons to be comprised within a VAT group: each must be established in the relevant territory, and they must be closely linked with one another. There was nothing in the context or objectives of art.11 that indicated anything other than this plain reading. It was common ground that the twin objectives of art.11 were (a) simplifying administration for VAT group members and the tax authorities and (b) helping to combat abuses such as splitting up one undertaking into several taxable persons. Neither of these objectives supported the company's interpretation.

There was nothing in the wording or in the context to support the company's argument that the territorial restriction could be satisfied by "the close links between the persons being forged in the territory", as opposed to each individual member having an establishment in the territory. The judges found support for this in CJEU decisions such as

Commission v Ireland (Case C-85/11). A number of other arguments based on other decisions were rejected in turn. The UT was satisfied that the company's main contention was not correct.

Turning to the question of interpreting the words "fixed establishment", the company tried to make something of different wording in different provisions of the 6th Directive. However, the company's representative could not suggest an alternative meaning for the phrase "established in the territory" in art.11 PVD, if her primary submission on the "substantive condition" was rejected. Accordingly, HMRC's position (that the place of supply rules were to be followed) was preferred.

The contention that registration under the Companies Act was enough to constitute a fixed establishment was also rejected. The intention of Parliament in drafting s.43A had clearly been to use the VAT concepts on place of supply. The case law in which that had been discussed, and the Implementing Regulations provisions, were not directly imported into art.11 because they dealt with place of supply rather than grouping; however, they were all relevant as a starting point in considering whether a body was "established in the territory".

The argument about failure to consult the VAT Committee did not assist the taxpayer. The problem was that the grouping provisions were optional and therefore not of direct effect. This had been considered by the CJEU in *Larentia*, where the taxpayer was not entitled to rely on direct effect to enforce a right to grouping. The UT considered that it would be illogical to confer enhanced rights on a taxable person as against the Member State in the case of a procedural requirement to consult the VAT Committee.

HSBC tried to characterise HMRC's action as "applying direct effect against the taxpayer", which is not permitted where the state has failed to properly implemented the Directive. The UT did not agree: if there was no grouping, HSBC would definitely be liable for a reverse charge. It was not correct to treat the argument as "HMRC relying on the Directive which had not been properly implemented" – rather, HSBC were seeking to rely on direct effect of the Directive and choosing how they would have preferred it to be implemented. The failure to consult the VAT Committee was not relevant to the appeals.

Turning to the question of measures that are permitted to restrict grouping in order to prevent tax avoidance and evasion, the UT considered precedents on tax avoidance including *Halifax* and *Direct Cosmetics*. The main distinction between the two was that *Halifax* required tax avoidance to be the sole or main purpose of the arrangements, whereas *Direct Cosmetics* did not. HMRC argued that the concepts of "abuse" and "avoidance" were separate in EU law, and there was nothing in art.11 to suggest that "avoidance and evasion" was restricted to "abusive" situations.

The UT noted that the PVD uses the expressions "avoidance and evasion", "evasion, avoidance and abuse" and "evasion" alone in different contexts. Given that the PVD was drafted at the same time as the *Halifax* case was being heard by the CJEU, the UT considered that the choice of words in art.11 was deliberate and should be respected. The measures that Member States were permitted to introduce under art.11 were not restricted to abusive arrangements under *Halifax* but extended to the concept of avoidance as set out in *Direct Cosmetics*.

The issue arising in relation to s.84(4D) was whether HMRC's decisions were flawed because there was no adequate reason for the date chosen for the removal of the service companies from the group. HMRC's preliminary decision was to remove them with effect from 1 October 2013, which was apparently chosen because any assessments relating to earlier periods would have been time-barred. The company argued that this was not a proper consideration: HMRC should have formed an opinion on the first date on which the grouping conditions were not satisfied, and the Tribunal would need to know that date in order to exercise its supervisory jurisdiction (i.e. in considering whether the decision was reasonable). In effect, the company was arguing that HMRC should have chosen an earlier date than 1 October 2013.

The UT rejected this argument, because there was nothing in s.43C(4) which required HMRC to choose the earliest possible date for removing a company from a group. The only restriction was that they could not specify a date earlier than the date on which the company was not eligible. As a result, there was no right of appeal on this point under s.84(4D). The UT also considered that "the ability to raise a valid assessment" would be a relevant factor in deciding on the date of exclusion.

Lastly, the UT considered one more potential ground of appeal against the choice of 1 October 2013 as the date for removal. The company argued that the 90-day period for objecting to a group registration application had long expired, and any questions about whether the subsidiaries were established in the UK should have been raised during that time. If that had solely related to the date specified in the removal notice, the UT would not have considered it valid, because that would suggest that HMRC could not make such a decision at all after the 90 days had expired.

However, the company claimed that HMRC had changed their policy in 2014, and could not apply the new policy retrospectively, having failed to object to the grouping applications within the 90-day period allowed by the law. Without expressing any views that might influence the FTT's decision on the matter, the UT did consider that this was a valid ground of appeal that engaged s.84(4D). That appears to be the only victory for the taxpayer in the whole preliminary hearing.

Upper Tribunal: *HSBC Electronic Data Processing (Guangdong) Ltd and others v HMRC*

6.1.2 Group registration and EU law

S is a German foundation governed by public law and the sponsor of a university, which operates inter alia a university school of medicine. It is a taxable person and provides services for consideration (patient care). At the same time, as a legal person governed by public law, it performs tasks in an official capacity (the teaching of students) in respect of which it is not considered to be a taxable person. S is the representative member of a university school of medicine and a company U. It is subject to VAT in respect of the economic activities that it carries out for consideration, while it is exempt from VAT in respect of activities that it carries out in the exercise of its powers as a public authority.

U provides S with cleaning, hygiene and laundry services, as well as patient transport services. These services related to the whole of S's

premises, which included areas used for economic and for non-economic activities, and also common areas used for both. 7.6% of the area was devoted to public authority activities. In the year in dispute (2005), S considered that payments to U were covered by the disregarding of internal supplies within a VAT group.

The tax authority considered that the services supplied by U to S in respect of its public authority activities fell within the principles of self-supplies for "purposes other than those of the business", and were therefore subject to an output tax charge. This led to an assessment for €841 and an appeal that has been travelling through the courts ever since.

The questions referred to the CJEU ask whether the German law is acceptable in defining the "taxable person" in the case of a VAT group as the representative member to the exclusion of all the other members. A-G Medina has considered this in a parallel opinion in Case C-141/20. In his view, the members of a VAT group do not lose their status as a 'taxable person' as long as the members of the VAT group do not cease to carry out independent economic activities; when Member States exercise the choice afforded to them by the Directive and when they lay down certain conditions for VAT groups, they may not fundamentally alter the nature of the concept of a VAT group and the aim of that provision. They may not deprive certain VAT groups and persons, which otherwise fulfil the related requirements under the Sixth Directive, of the benefit of those rights. The objectives of the second paragraph of the grouping provision are to prevent abuse and combat tax evasion and avoidance, and to simplify administrative operations by exempting intra-group transactions from VAT.

The discussion of the grouping rules appears to relate to specific issues with the way those rules work in Germany. The A-G considered that this has been an issue for some time, having been considered by the CJ in such cases as *Larentia + Minerva* and *Marenave*; the referring court appeared to be concerned that an answer supporting the taxpayer could lead to "substantial tax losses in Germany", but the A-G observed that Germany should not have ignored the problems raised in earlier cases but should have taken steps to correct the anomalies.

His suggested answer was that entities that satisfied the conditions for grouping should be eligible to be treated as a single taxable person, but that did not preclude treating each member of the VAT group as an independent taxable person. The Directive precludes national legislation which stipulates that only the controlling company of the VAT group becomes a taxable person, while the remaining companies are regarded as non-taxable.

The A-G's conclusions on the first question meant that it was not necessary to consider the second question (about the self-supply rules). However, he commented briefly that:

- the services were not carried out "free of charge", because U charged S for them;
- they were not "for purposes other than those of the business", because they were within the purposes of S acting as a public authority – they were not for private purposes in the sense of being outside the aims of the entity itself.

The self-supply rules were therefore not applicable.

CJEU (A-G) (Case C-269/20): *Finanzamt T v S*

The related opinion referred to above is more explicit about the problems with the German grouping rules. The A-G quotes academic articles that state "'[that regime] reminds [one of] the poisoned apple given by the evil queen to sweet Snow White. Albeit designed as a facilitation measure, VAT grouping has become a focal point of audit for the German tax authorities… led to numerous court cases… resulting [in] a bureaucratic jungle for taxpayers who are often lost when wondering if their supposed VAT group is likely to withstand an audit."

The case concerned a dispute about whether two companies (NGD and A) were eligible to be grouped in 2005. NGD was owned 51% by A and 49% by C; NGD's sole manager was E, who was also the sole manager of A and an executive board member of C. Two versions of possible articles were presented to the tax authorities to obtain a ruling on what would be eligible for grouping. The tax authorities stated that only the second version qualified, but the company was formed on the basis of the first, and the second version was only put into effect in 2010.

In the course of an audit, the auditor concluded that the conditions for grouping were not met in 2005 because A did not have voting control, in spite of owning 51% of the shares. The VAT return for 2005 was only filed (on a provisional basis) in December 2013; the tax authority confirmed the auditor's ruling in May 2014; an objection to that decision was rejected by the tax authority in February 2017, but the court of first instance upheld the taxpayer's appeal in February 2018 on the basis of the *Larentia + Minerva* and *Marenave* decisions of the CJEU. The tax authority appealed, and the appeal court referred questions to the CJEU. The court observed that the German national law was unequivocally in favour of the tax authority, but it had been called into question by the CJEU and had not been amended afterwards.

The company argued that the German rules were not compatible with the conditions of the grouping provisions in the PVD (or the Sixth Directive), in that the designation of a member of the group as "the taxable person" (rather than regarding the group as a whole as a deemed taxable person) was not a measure aimed at preventing fraud, evasion or abuse, nor did it simplify the administration of the tax. The Commission agreed with this.

The German authorities argued that the proper question was whether NGD was sufficiently financially integrated with A to be regarded as eligible for grouping, and that the compatibility of the German law was not the issue. The government claimed that the effects of the German law were fully compliant with the Directives, in that all members of the group were regarded as a single taxable person and submitted a single VAT return.

There was also an argument about the admissibility of the questions, because the German authorities considered that they did not relate closely enough to the circumstances of the case. In their view, answering the questions would not help to come to a decision. The A-G considered that these objections were unfounded, not least because of the differing views of the two levels of appeal in the German courts.

Turning to the questions themselves, the A-G notes that "the Sixth Directive provides Member States with rather limited guidance on how to

implement the VAT group regime in their domestic legislation". He summarises the problem with the German law as "the fact that, under the Sixth Directive, independent companies that are closely linked to one another for VAT purposes do not lose their quality as taxable persons simply because of that link. The concept of a VAT group in no way results in each taxable person in that group being replaced by a single member of that group."

The A-G compares the German law with the Directive and concludes that the German law is more restrictive, and the extra restrictions cannot be justified. He goes on to say that each member of the group remains a taxable person with VAT obligations of its own, which is ignored by the German designation of only the controlling company as "the" taxable person. "The VAT group established by the second subparagraph of [art.4(4) 6th Directive] is intended solely to simplify the treatment of VAT. In practice, tax authorities should receive a single VAT return constituting an aggregation of the individual returns of each taxpayer belonging to the group."

The Commission gave a simple example of the operation of a two-company group buying and selling goods to illustrate how the grouping rules ought to work. The A-G quoted this, pointing out that both companies had VAT obligations and acted as taxable persons, and the sharing of the group's VAT liability between them was a matter for national contract law. It was not permissible to regard one of them as not an independent operator at all.

In addition, the Directive allowed the group to choose its representative member, whereas the German law designated only the controlling company. The German law made the controlling company solely responsible for all the VAT obligations, whereas that ought to be the joint responsibility of all the members of the group, who were a "deemed fictional entity" in EU law that had never been recognised by the German law.

The A-G finished by considering, and rejecting, the argument that the German rules could be justified as a derogation permitted by the Directive. There was no clear relationship between the designation of the controlling company as the sole taxable person and the prevention of fraud, evasion or abuse.

CJEU (A-G) (Case C-141/20): *Finanzamt Kiel v Norddeutsche Gesellschaft für Diakonie mbH*

6.1.3 VAT Group Registration applications

The Chartered Institute of Taxation has published some guidance from HMRC about action that traders can take while waiting for their applications for grouping to be processed. This has been subject to exceptional delays over the last year, leading to uncertainty over how the traders should account for VAT. It is surprising that the CIOT's technical department has issued the guidance rather than HMRC, and its legal status was unclear. It reads as follows:

For several months we have been in discussions with HMRC, seeking to obtain clarity on how businesses should account for VAT while waiting for HMRC to approve (or otherwise) their VAT grouping applications.

This has gained increasing importance as there have been lengthy delays in HMRC responding to such applications.

We have received guidance from HMRC, reproduced below, in respect of the VAT issues arising when a VAT group registration application is delayed. Please note that the CIOT continues to discuss the position with HMRC as we are aware that there are differing experiences of our members that have not matched what the guidance sets out. We will publish an update in due course.

Submitting Returns

Whilst the application is processing, if the single entity and/or the VAT group are already VAT registered, their VAT returns must be filed as they become due. These returns should be calculated correctly, as if the application was not happening.

Sales and purchases should be included on the relevant VAT return. Any supplies between the group and single entity must be treated as normal sales and purchases.

Failure to submit VAT returns, pay their VAT bill on time or submitting inaccurate return figures can result in default surcharges and/or civil penalties. See VAT Notice 700/50 and VAT Notice 700/42 for more details.

Processing your client's Application

When your client's application is processed, if there has been a delay, some additional steps may be required so they can join the group from the date requested. If this is the case with your client's application, we will contact you, explain the situation and what steps we need you to do.

Depending on the specifics of the case, we may need to:

Cancel a submitted VAT return for the single entity, if the period overlaps with the date your client wants to join the group. If that return resulted in repayment, they will need to return that repayment to us.

Ask you to complete a VAT return, covering the start of the cancelled period to the date your client asked to join the VAT group.

Ask you to make an adjustment on the VAT Group's next VAT return or submit an error correction, once it is confirmed that the single entity has joined the group.

We hope these steps will only be required in rare cases. When they are, HMRC will fully inform and support you to make the process as smooth as possible.

Example

Company A is VAT registered and applies to join VAT Group B with other companies. Company A request that they join the group from 14th February.

Company A has a VAT return period running from 1st December to 28th February, so must submit their return by 7th April. As they have not had a response, they submit their return prior to the due date. This return would take into account the supplies made and received by Company A alone.

When the application is worked, HMRC sees the submitted return which covers the requested Group registration date. A VAT Groups Caseworker contacts the person who completed the VAT50/51 form to explain the situation. In order to process the change at this date, the submitted February VAT return must be cancelled, and a manual VAT Return will be required from 1st December to 13th February.

If you have any further queries on this matter, please send them to technical@ciot.org.uk and we will seek any further clarity required.

www.tax.org.uk/vat-group-registration-applications-vat-accounting-and-reporting-pending-hmrc-s-response

Following this advance comment by the CIOT, HMRC issued a Brief to explain how businesses should file their VAT returns while waiting for a decision on their VAT grouping application. HMRC now say what is effectively the complete opposite of the above:

Whilst waiting for a response to the VAT grouping application, businesses should:

- *treat the application as provisionally accepted on the date it was submitted online or the date it should be received by HMRC if submitted by post;*
- *account for VAT accordingly.*

While businesses are waiting to receive the VAT grouping registration number, they may receive:

- *an automated assessment letter;*
- *letters asking for payment of any automated assessments;*
- *notification of a default surcharge for not have filed the tax return.*

Businesses will not need to take any action in response to any of these notices. HMRC will automatically cancel them once the group application is fully processed.

If businesses followed the previous guidance and submitted VAT returns to HMRC using previous registration numbers, they do not need to take any steps to change this.

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6.2 Other registration rules

6.2.1 Article

In an article in *Taxation* mainly aimed at students, Sophie Hill highlights basic VAT issues to bear in mind on starting a UK business and when ceasing trade.

Taxation, 24 February 2022

6.3 Payments and returns

6.3.1 Late payment interest rates

The Bank of England Monetary Policy Committee voted on 2 February 2022 to increase the Bank of England base rate to 0.50% from 0.25%.

HMRC interest rates are linked to the Bank of England base rate (by the addition of 2.5%).

As a consequence of the change in the base rate, HMRC interest rates for the late payment will increase to 3.0%. These changes will come into effect on:

- 14 February 2022 for quarterly instalment payments
- 21 February 2022 for non-quarterly instalments payments

Repayment interest rates remain unchanged at 0.5%.

www.gov.uk/government/news/hmrc-late-payment-interest-rates-to-be-revised-after-bank-of-england-increases-base-rate--2

Following the further increase in base rates from 0.5% to 0.75%, HMRC's late payment interest rates rose to 3.25% for most taxes with effect from 5 April 2022.

www.gov.uk/government/publications/rates-and-allowances-hmrc-interest-rates-for-late-and-early-payments/rates-and-allowances-hmrc-interest-rates

6.3.2 Consultation response

CIOT has published its response to the HMRC consultation on modernising tax debt collection from non-paying businesses. This was in the form of a "call for evidence"; CIOT welcomed the fact that this represents an early consultation rather than something done once plans have already been made. The CIOT notes that there seems to be little evidence of abuse of the present rules, and it might be more appropriate for HMRC to use their existing powers rather than being given new ones. If there is an extension of HMRC's powers, it should be subject to proper oversight and safeguards.

The CIOT also recommends that the impact of the new VAT penalty regime is appraised before making any further changes to HMRC's debt recovery powers.

https://www.tax.org.uk/ref891

6.4 Repayment claims

6.4.1 Entitlement to input tax without invoice

The CJEU has now ruled on the *Zipvit* case, bringing the long-running saga to a close. The court has agreed with the overall conclusion of the A-G – that the claimant was not entitled to its input tax – but for a completely different reason, one that the A-G's opinion discounted.

Historically, the UK regarded all delivery services supplied by the Royal Mail as exempt. This was held to be incorrect in the case of *TNT Post UK* (Case C-357/07, 23 April 2009): only the "public postal service" was covered by the PVD exemption, which referred to the "universal service obligation" of the national provider. Individually negotiated contracts should not be exempt, because they existed within a competitive marketplace.

Up to that point, Royal Mail and its customers had both assumed that the supplies were not VATable. Royal Mail had contracts which provided for the possibility of collecting VAT in addition if VAT was found to be due, but the company decided not to enforce that provision – it was not commercially practical to go to all its customers for the preceding four years and try to collect the money, even where those customers might be willing to pay (because they would be entitled to a deduction). Furthermore, HMRC took the decision not to attempt to collect the VAT from Royal Mail; as the law had been wrong, HMRC considered that they had created a legitimate expectation on the part of Royal Mail that it was not required to collect VAT in respect of the services, so that Royal Mail could have expected to have a successful defence to any attempt to issue assessments against it to account for VAT in respect of the services.

It took some time after the *TNT Post* decision for the extent of its impact to be determined. In 2010, a number of companies made claims for the input tax that they considered they had paid over to Royal Mail on supplies purchased between 1 January 2006 and 31 March 2010. The leading case involved about £415,000, but it is estimated that the total amount of all the claims is between £500 million and £1 billion.

HMRC refused the claim for input tax on the basis that the claimant had not paid any. The claimant argued that it had purchased taxable supplies, and the VAT fraction of what it had paid must therefore be regarded as input tax. It should not be affected by HMRC's decision not to assess Royal Mail.

The First-Tier Tribunal decided that there was no VAT 'due or paid' within art.168(a) PVD, and dismissed the company's appeal. Further, as the company did not hold valid tax invoices in respect of the supplies, it had no right to claim. The decision was strengthened by the fact that the opposite result would give the trader a windfall profit that had not been expected at the time it contracted for the supplies.

The Upper Tribunal and Court of Appeal dismissed further appeals, but the Supreme Court decided to refer questions to the CJEU. The questions are long and complex, but in essence they ask whether:

- the amount paid for a taxable supply is VAT-inclusive, even if the supplier, the customer and the tax authority all thought at the time the supply was exempt;
- the decision of the tax authority not to collect VAT retrospectively was relevant to the question of whether VAT was 'due or paid';
- the absence of a tax invoice ruled out a claim.

Advocate-General Kokott gave her opinion, covered in the October 2021 update. She recognised first that this is not an uncommon situation: tax authorities make mistakes about the law, which are put right by case law

decisions, which the traders involved cannot realistically be expected to anticipate.

She decided to answer the third question first, because if a tax invoice was necessary, the other questions would fall away. She started by drawing a distinction between a "right to deduct in principle" and the "right to deduct in a given amount". The right in principle arises immediately on receiving a taxable supply that meets the conditions for deduction in art.168. Most of the cases on input tax concern that right, and the CJEU has consistently held that the right is fundamental and cannot be limited.

The A-G considered that "the right to deduct in a given amount" was a separate principle, governed by art.178 rather than art.168. This requires the claimant to hold an invoice. The neutrality of the tax requires the purchaser of an input to be relieved of the burden of tax paid, but that burden only arises on the payment of consideration for the supply, which is initiated by the issue of an invoice.

Cases on the significance of invoices include *Biosafe* (Case C-8/17) and *Volkswagen* (Case C-533/16). These held that the time limit for the customer's claim to deduction only ran from the time that the customer held an invoice, not from the time of supply itself. This indicated that a customer who did not possess a VAT invoice had not yet incurred a charge to VAT, and could therefore not claim it.

The A-G considered other precedent cases on alternative evidence to support a deduction and on correction of incomplete or incorrect invoices. In her view, the fact that an invoice described a supply as exempt and did not separate out an amount of VAT chargeable was fundamental: it could not be regarded as a slightly flawed tax invoice. Possession of an invoice was a substantive requirement, not a mere formal requirement.

Her recommended answer to the third question was therefore: "the right of deduction presupposes the supply of the goods or services and the possession of an invoice (art.178(a) PVD) documenting the passing on of VAT by virtue of being stated separately. Consequently, without such an invoice, the applicant is not entitled to claim to deduct input tax in the present case."

In case the full court did not agree that this determined the issue, the A-G went on to examine the first and second questions. She concluded that the reference in art.168(a) to "VAT due or paid" was to the VAT due from or paid by the supplier to the Member State concerned, not VAT included in the consideration paid by the customer to the supplier. As the supplies were in principle taxable, there was in the abstract "VAT due" from Royal Mail to HMRC; however, as the limitation period for assessing that tax had long ago expired, that was only a theoretical liability. Nevertheless, the case law of the court consistently held that the claimant's right to deduct was independent of the supplier's payment of the output tax to the authorities. That part of the opinion favoured the claimants, but the necessity of an invoice overrode the favourable conclusion.

The full court started by considering the question of "VAT due or paid". It was well established that the price paid should generally be regarded as inclusive of any VAT that was due. However, in the circumstances of the present case, that did not determine the outcome. The parties had entered into a contract on the mutual understanding that the supply was exempt

and the price was VAT-exclusive; Royal Mail could have charged Zipvit the VAT in addition once it discovered that VAT should have been charged, but it did not, and HMRC had not pursued the liability because of the protection of legitimate expectations. In such circumstances, the customer could not be regarded as having paid VAT when it had not been charged any and has not passed it on to the final consumer.

Although art.167 provides that the right of deduction arises at the time when the deductible tax becomes chargeable, and art.63 provides that the tax becomes chargeable at the time of the supply, the court held that the mere fact that a supply exempt from VAT is ultimately regarded, once completed, as being subject to VAT cannot suffice for a finding that that tax is deductible if no request for payment of that tax has been sent to the recipient of that supply, even though it is not impossible for the supplier to address such a request to that recipient. In the circumstances, the VAT could not be regarded as "due or paid".

As a result of this answer to the first, second and fourth questions, the court did not consider it necessary to answer the third question (about the necessity of holding a VAT invoice).

CJEU (Case C-156/20): *Zipvit Ltd v HMRC*

6.4.2 The other postal claim

Meanwhile, the High Court has considered two preliminary issues in the related group action in which Royal Mail customers are trying to force Royal Mail to issue tax invoices so they can recover input tax. The Court of Appeal decided in 2021 that the claimants did not have a private law right of action against the company for its failure to issue VAT invoices, but they have returned with a second argument. This is likely to continue to be argued for some time.

The preliminary issues considered by Mr Justice Adam Johnson were:

- whether the services supplied were properly exempt under EU law during the claim period;
- whether Royal Mail should be treated as "an emanation of the State".

The arguments are largely historical (Royal Mail was privatised in 2013, but did not dispute that it was an emanation of the State before that) and very lengthy. In summary, the judge decided that most of the supplies were properly exempt because Royal Mail was acting in the capacity of "the public postal services"; he also held that the supplier was an emanation of the State, which means that it cannot rely on the direct effect of EU law in an action against a commercial company. The next step in the litigation will consider the consequences of those findings.

High Court: *Claimants in the Royal Mail Group Litigation v Royal Mail Group Ltd*

6.4.3 End-customer claims

HMRC have published a Brief concerning the possibility of an end-customer claiming overcharged VAT directly from the tax authority. This was considered in the CJEU case of *Reemtsma* (Case C-35/05); according to the principles of the *San Giorgio* case (Case 199/82), the tax authority should not withhold taxes that have been collected in contravention of EU

law, and if the normal route to reclaiming them is not possible or excessively difficult, a person who has borne the tax should be able to recover it directly from the tax authority.

The UK Supreme Court acknowledged this principle in the 2017 case of *Investment Trust Companies (in liquidation) v HMRC*, but held that the circumstances did not meet the exceptional threshold for a direct claim to be available. The "normal route" in the UK is for the supplier to claim a repayment under VATA 1994 s.80, and the supplier to pass on the repayment to the customer; although in the case the suppliers could no longer make a s.80 claim, the Supreme Court decided that the normal route could have been followed within the appropriate time limits, and the direct route was not available. HMRC acknowledged the effect of the decision in R&C Brief 4/2017.

HMRC have now stated that they believe the effect of the EU (Withdrawal) Act 2018 is to remove any right of action based on a failure to comply with any of the general principles of EU law (EUWA 2018 Sch.1 para.3). They state, without elaboration: "This included the right to bring a claim in the exceptional circumstances identified by the UK Supreme Court in *Investment Trust Companies* (claims brought in court before 1 January 2021, remain unaffected). If you believe you may be entitled to make a claim, you should seek professional advice."

Given that no one has yet succeeded in showing that the "exceptional circumstances" apply, this may not make a practical difference.

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6.5 Timing issues

6.5.1 Cash accounting and deduction

A German company, K, leased land from a lessor that had opted to tax the rent. It operated the cash accounting scheme (and it appears that the lessor also used the same scheme). From 2004 onwards, the lessor agreed to defer some of the rental payments. K paid part of the rent for the years 2009 to 2012 during the years 2013 to 2016, and was released from the obligation to pay the remainder in 2016. K claimed input tax on the payments it actually made in the periods in which it actually made them.

The tax authority carried out an audit and concluded that the deduction should have been claimed in the periods to which the rent related. Some of this could no longer be deducted because the periods were out of time. An assessment for €18,000 resulted for the years 2013 to 2016. According to German law, the right of deduction arises when the goods or services are supplied, regardless of when the tax becomes chargeable to the supplier and regardless of whether the tax is calculated by the supplier on the basis of the remuneration agreed or on the basis of the remuneration received. The referring court said this appeared to be an application of art.167a PVD; however, it was not sure whether this was overridden by art.167, under which the right of deduction arises only at the time when the deductible tax becomes chargeable.

The court examined the purpose of art.167a, which relates to an optional cash accounting scheme for small businesses, and its relationship with the derogations available in art.66, which had been implemented by Germany. The timing of deduction in art.167 was based on the time that the tax became "chargeable", which was subject to the rules in articles 64 to 66, where they had been implemented by the member state concerned. The court ruled that they dealt with different situations, and the German rules were unacceptable in enforcing a time of deduction based on actual delivery tax points in a situation in which the tax was chargeable on the basis of amounts received.

CJEU (Case C-9/20): *GrundstücksgemeinschaftKollaustraße 136 v Finanzamt Hamburg-Oberalster*

6.6 Records

6.6.1 Reminder on MTD

HMRC have issued a reminder to businesses that have not yet signed up for Making Tax Digital for VAT that it will become mandatory for all VAT-registered businesses (unless exempt) from 1 April 2022. The note comments:

As of December 2021, nearly 1.6 million taxpayers had joined Making Tax Digital for VAT with more than 11 million returns successfully submitted. Around a third of VAT-registered businesses with taxable turnover below £85,000 have voluntarily signed up to Making Tax Digital for VAT ahead of April 2022, and thousands more are signing up each week.

It still seems likely that there will be a fair number of businesses that are unaware of the requirement or are unprepared for the change.

www.gov.uk/government/news/making-tax-digital-for-vat-is-coming-are-you-ready

6.6.2 Sign up illustration

The CIOT has published guidance to help those businesses who will become subject to MTD for VAT from 1 April 2022 to understand when they should sign up for the system. The guidance comprises a written explanation and a timeline in a spreadsheet that sets out the relevant sign-up windows, depending on the business's VAT return stagger and whether it has a direct debit set up.

https://www.tax.org.uk/mtd_sign_up

6.7 Assessments

6.7.1 Suppression of takings

A husband and wife partnership running a convenience store in a depressed part of Blackpool appealed against assessments to income tax and VAT and related penalties in respect of suppressed takings. The judge agreed with HMRC that there had been dishonesty, but made some adjustments to the calculations to take account of some receipts being accepted as loans rather than from trading, and the last period of trading before closure being likely to be less profitable than previous periods as the business was in decline. The appeal was allowed to that small extent.

First-Tier Tribunal (TC08427): *Best On Convenience Store (a firm)*

6.7.2 No suppressed takings

HMRC raised assessments and denied a repayment totalling £40,437 after finding that a company had declared sales of £262,346 over four VAT periods, but had banked £422.308. The company claimed that the additional bankings arose from trade debtors, injections of cash by way of

a director's loan account, further injections of cash by way of loans from an associated company and advance payments.

Judge Nigel Popplewell started by setting out a description of the company's business model, which was to organise the delivery of goods manufactured in Pakistan to customers in the UK. The customers would sometimes pay for the goods to the company's bank account in order to avoid foreign exchange restrictions in Pakistan. The HMRC officer who raised the assessments had been unable to reconcile the information provided during the enquiry, and raised her assessment on a "best judgement" basis. Due to personal circumstances she was unable to attend the hearing and had not given a written statement, so the Tribunal had to consider the validity of the assessment without a detailed explanation from her.

The judge concluded that the officer had found the company's business model "unlikely", and had probably been influenced by this belief. Nevertheless, the bar for a "best judgement" assessment was a low one, and the officer appeared to have taken into account all the relevant information that she had before her.

The burden then shifted to the appellant to show that the assessments were numerically incorrect. The judge was wholly satisfied that it had done so. The evidence presented to the Tribunal on the day of the hearing was convincing, and the judge found the business model to be thoroughly credible. The company's accountant provided explanations that were coherent and convincing. On the balance of probabilities, the appeal was allowed.

First-Tier Tribunal (TC08420): *Starz Traders Ltd*

6.8 Penalties and appeals

6.8.1 Penalty reform for VAT

CIOT has published a table provided by HMRC setting out the first affected accounting period for the reformed penalty provisions for VAT late filing and payment. The table reflects that there will be a one year 'period of familiarisation' with the new late payment penalty regime. Once the new regime is in place from 1 January 2023, HMRC will take a "light-touch approach" to the initial 2% late payment penalty for taxpayers in the first year of operation. In the first year, where a taxpayer is doing their best to comply, HMRC will not assess the first penalty at 2% after 15 days, allowing taxpayers 30 days to approach HMRC before HMRC charges a penalty. HMRC's policy paper contains further information under the heading '*Where HMRC might not assess a late payment penalty*'. While the policy paper says 'where a taxpayer is doing their best to comply', HMRC have confirmed that they do not apply a behavioural element to the period of familiarisation and that they will apply the same approach to everyone. HMRC have also confirmed that the current 'default surcharge' regime will continue as normal throughout 2022, without any specific easement or 'soft landing' for new Making Tax Digital (MTD) businesses.

https://www.tax.org.uk/penalty-reform-for-vat

6.8.2 Penalty

A company accepted that its returns had been inaccurate, but appealed against a penalty based on "deliberate behaviour". It also considered that greater mitigation should have been given for quality of disclosure. Judge Abigail McGregor noted that the bundles provided by HMRC to the Tribunal were not the same as the bundles that HMRC's representatives and witnesses had in front of them. This caused "a significant amount of confusion and delay".

HMRC's decision on "deliberate behaviour" was based on the following assertions:

(1) Atlas had made inaccuracies of the same nature in 2014 and was advised of how it should be accounting for their hire purchase sales at that time;

(2) Atlas had not made any changes to the procedures and was still accounting for hire purchase sales in the same incorrect way in 2019;

(3) On the first day of the assurance visit, Ms Knowles had asked Atlas whether there was any 'bumping' and was told there had not been;

(4) The assurance visit had unearthed 'bumping' in relation to negative equity car sales whereby the value of the vehicle sold had been inflated on the documentation entered into with the finance companies, which had in turn given rise to unpaid VAT;

(5) When challenged on this, both Mr Hudspith and the sales manager at Atlas had said that they knew that this happened and that if they didn't do it, the customer would go elsewhere.

The company responded that the 2014 errors were similar but had been very small. It was argued that HMRC had misunderstood the finance documentation, which showed the negative equity on part exchanges, and these were the figures the customer agreed to. Some finance providers required the selling price and the negative equity to be consolidated into a single figure, which the company argued was contrary to economic reality. The failure to appreciate that this gave rise to understated VAT was careless, not deliberate.

The company's witness claimed that there was a difference between HMRC's understanding of "bumping" and that used in the car trade. This had led to a misunderstanding during the visits to the trader: on the first day the company had stated that there was "no finance bumping", but on the second day accepted that there were negative equity sales. The officer appeared to regard these as the same thing.

The judge did not consider that HMRC had met the burden of showing that the company had consciously and intentionally submitted incorrect returns, or consciously and intentionally chosen not to find out how to make sure the returns were correct.

The judge next considered the mitigation allowed by HMRC, which was:

- 15% (of a maximum of 30%) for telling;
- 30% (out of 40%) for helping;

- 30% (out of 30%) for giving access.

The reduction for telling was because of the denial of "bumping" on the first day of the visit, which the company claimed had been because of a misunderstanding. The reduction for helping was because documents had not been provided; the company claimed that HMRC had asked for about 100 documents, and only 3 were not provided straight away. HMRC also referred to only appointing an adviser after the assessment had been raised as "unhelpful".

The judge agreed that the point about bumping was not enough, on its own, to deny half the mitigation available for telling. On helping, an e-mail from the officer to the company immediately after the visit was evidence that the company had not been slow. She had also sent another e-mail later with a draft assessment stating that she would give full mitigation for telling, helping and giving access. The judge also did not agree that appointing an adviser 5 weeks after the site visit was unhelpful, given that in the meantime the company had been cooperating and providing information to HMRC. The judge uplifted the mitigation to the full amount available.

HMRC had applied a policy from the Compliance Handbook at CH82465 which changes the penalty range where there is a considerable delay between the date of the inaccuracy and the date of disclosure. This means that the minimum deliberate conduct penalty becomes 45% rather than 35%; the range for a careless penalty (which the Tribunal had decided would apply in this case) would be 10% to 30% rather than 0% to 30%.

There was some discussion of the statutory basis of this policy and whether it was communicated in factsheets given to the company. The company argued that it was not statutory, and should rather be part of the "telling" mitigation factors. It appeared to be more concerned with unprompted disclosures, where there was more logic to taking into account a delay in the taxpayer putting things right. Nevertheless, the judge did not consider that this policy infringed the statutory rules: HMRC were given some leeway in how they applied mitigation, and this was not an irrational use of discretion.

Lastly, the company argued that HMRC had overstated the potential lost revenue by offsetting overdeclarations against careless inaccuracies before applying the deliberate penalty scale to the remainder. The judge stated that the rules required understatements and overstatements in the same period to be set against each other in determining PLR, and overstatements had to be set off first against understatements where the taxpayer was not liable to a penalty before being set against careless errors and then deliberate errors. HMRC had therefore applied the rules correctly, but as the errors had all been held to be careless, the order of offset would no longer matter.

The appeal was largely allowed, reducing the scale to careless, increasing the mitigation to the maximum, but confirming the 10% restriction for delay. The financial effect is not specified in the decision.

First-Tier Tribunal (TC08431): *Atlas Garages (Morpeth) Ltd*

6.8.3 Costs

Following the directions hearing reported in the January 2022 update (TC08266), the company applied for further directions concerning the application of the costs regime. The appeal relates to a disallowance of input tax on *Kittel* principles; it has resulted from the consolidation of two separate appeals, the first of which was originally classified as "standard". The company claimed that it was unaware that the consolidated appeal had been classified as "complex" (meaning that the Tribunal could award costs to the winner, without requiring "unreasonableness" of the other party). The company applied for a direction to recategorize the consolidated appeal as "standard", or in the alternative, to allow it to opt out of the costs regime.

Judge Aleksander, considering the matter on the papers alone, refused the application about categorisation. In his view, the appeal was properly considered to be complex according to the criteria for the Tribunal's allocation of cases.

He considered the relevant principles to be applied in relation to what amounted to a late application to be removed from the costs regime. Although the *Denton* and *Martland* principles for allowing late appeals to be heard were not directly applicable, they could be adapted for this purpose. The delay of over 1,000 days was significant and serious; however, the judge accepted that the original categorisation, followed by the consolidation around the time that the original representative resigned and was replaced, was a reasonable explanation for the company being unaware of the new categorisation. The prejudice to the company from not allowing the application would be greater than the prejudice to HMRC from allowing it. The effect was to grant an extension of time to make the application, which would then have to be filed within 28 days of the release of the decision.

HMRC had applied for costs in relation to the case management hearing referred to above. The judge noted that the rules were different in relation to case management hearings, and it would be open to HMRC to apply for costs of that hearing, regardless of the outcome of the substantive appeal.

First-Tier Tribunal (TC08354): *Greencyc Ltd*

6.8.4 Late appeals

A company sought leave to appeal out of time against VAT and corporation tax assessments notified in April 2017, and penalty assessments relating to the tax issued in June 2017. The company had gone into liquidation in April 2017; HMRC had issued PLNs to the director, Mr Uddin, who had tried to appeal against the assessments on behalf of the company. This was not possible at the time because the liquidator had to authorise it. This permission was given in November 2020, and at that time Judge Fairpo heard an application by Mr Uddin to appeal out of time against the PLNs. She refused the application; Mr Uddin provided the present judge (David Bedenham) with a copy of her decision, together with his further application to the Upper Tribunal to be allowed to appeal out of time.

The taxpayer's representative accepted that the delay in appealing (16 to 18 months) was significant and serious. The reasons that were put

forward were that the taxpayer's accountant had misled him into believing that the matter was in hand, and the liquidators did not give permission for him to appeal. The consequences to him of not being allowed to appeal would be serious.

The judge did not agree that the situation was significantly different from that in *Katib*, where it was held that the failure of a taxpayer's agent was a failure of the taxpayer. There was no principle that excused the taxpayer because the agent had misled him; in this case, the taxpayer claimed to have met the agent "many times" and been assured that the matter was in hand, but had not followed this up by asking for a copy of the appeal or written confirmation of the situation. When he finally decided that something was wrong, it still took several more months before an appeal was filed.

The liquidators were responsible for filing an appeal on behalf of the company. No reason had been put forward for their failure to do so. The director's eventual appeal on behalf of the company had to be tested against the reason for the delay throughout the period, and there was nothing to justify that delay.

The application was dismissed.

First-Tier Tribunal (TC08350): *Kazitula Ltd (in liquidation)*

A company applied for leave to have its appeal heard out of time in relation to a number of HMRC "*Kittel*" decisions disallowing input tax on purchases of metal and related decisions levying penalties. The total amount involved was £630,000; the decisions and assessments were made between 8 February 2016 and 10 August 2018, and the notices of appeal were submitted on 24 September 2019. One appeal was therefore 2 years and 4 months late and the other was 1 year and just under 2 months late.

The company's counsel set out the history of the dispute, which showed that the company's accountants "appealed" to HMRC, possibly thinking that that was all they had to do. They also applied for a review. There were subsequent changes to the personnel involved on both sides; HMRC officers explained that, in the absence of an appeal, HMRC would seek to collect the tax assessed.

The company's representative accepted that the delays were significant and serious, but argued that the reasons for the delay included confusing and unclear correspondence from HMRC which did not explain what the company should do and what it must do to challenge the decisions. The fact that HMRC continued to discuss the assessments long after the deadline for appealing had passed contributed to the company's belief that it had done what it needed to do. It believed that its agents had filed appeals; while an agent's failure to do the right thing cannot on its own be an excuse for lateness, counsel argued that this belief was encouraged by HMRC's actions.

Judge Alastair Rankin noted the following extract from the Upper Tribunal's decision in *NT ADA*: "As already indicated, a failure by HMRC to provide adequate notification of appeal or review rights in the decision letter could also influence the exercise of the FTT's discretion to admit a late appeal." In the judge's view, the advice given by HMRC in their decision letters was confusing. The encouragement to lodge appeals given by HMRC officers during meetings and telephone calls led the

company to believe that its agents had complied. This was supported by the fact that HMRC's debt management department did not write to the company until 13 September 2019. HMRC had advised the company that it would not take any action to collect the disputed tax while the reviews of the decisions were being carried out, and in the absence of any demands from HMRC the company was entitled to believe that the decisions were under appeal. The amount of tax at stake suggested that there would be more prejudice to the company in refusing the application than there would be to HMRC in allowing it.

The application to allow the appeals to proceed to a substantive hearing was granted.

First-Tier Tribunal (TC08356): *Transwaste Recycling And Aggregates Ltd*

A company ran an OFSTED-registered children's home which was registered for VAT from November 2013 to September 2015, when it was deregistered by HMRC on the basis that its supplies were exempt. It submitted an appeal on 9 May 2019. The reasons for lateness were stated as the company attempting to avoid litigation by pursuing other avenues such as complaints to the Adjudicator and Ombudsman, and also trying to obtain a comprehensive answer to the company's arguments from HMRC – the director claimed that HMRC had "cherry-picked" aspects of the case but had never fully addressed his arguments. The Ombudsman had responded that the complaint needed to be dealt with by the Tribunal.

Judge Zachary Citron had before him witness statements from an officer of HMRC and the owner of the business, and also a transcript of a call made by the owner to the VAT Advice Line on 14 June 2012. The company's representative raised some objections to this document, but the judge considered that it was likely to be a contemporaneous record and more likely to be reliable than human recollection over such a long period.

It appeared from the transcript that the advisor had told the owner that the children's home would be exempt within the terms of the *Welfare* notice and was therefore ineligible to register. Nevertheless, the company made an online application for registration on 21 October 2013, stating that its business was "children's home (non-charitable)" and stating that it intended to make taxable supplies in the future. Registration was given effect from 1 November 2013.

The company submitted no VAT returns for the period during which it was registered. On 16 September 2015, HMRC wrote to the company stating that they had decided to cancel its registration because its only supplies were exempt. In March 2019, HMRC Debt Enforcement wrote to the company stating that there was an outstanding debt of £88,452 and threatening winding up proceedings.

The company's owner made various complaints following the deregistration decision. The Ombudsman pointed out that the proper route for dealing with an appealable VAT matter was to appeal to the Tribunal. In applying to be allowed to do this out of time, the owner put forward a number of arguments in support of his entitlement to be registered, mainly based on "legitimate expectation" and fairness.

HMRC did not object to the Tribunal permitting the late appeal. The judge nevertheless applied the *Martland* criteria and concluded that permission should not be granted. The reasons for lateness were not good

enough, but also the prejudice to the company was minimal: it made exempt supplies, so continuing its registration would not benefit it at all.

Even so, the judge had heard the substantive issues argued, in order to avoid the delay and inconvenience of an adjournment. He therefore set out what he would have decided had he given permission for the appeal to proceed. He was satisfied that the business was exempt under the law, so HMRC's decision had been reasonable. The company did not have a legitimate expectation that its registration would not be cancelled, because it had not given full or accurate details on the VAT 1: it had stated that it intended to make taxable supplies, when that was not the intention; also, the owner had been told this during the helpline call in 2012.

The owner had tried to introduce a wider argument that local authorities were able to recover VAT on costs in relation to similar activities within s.33 VATA 1994. This was not an appealable matter within s.83, and the judge did not see a close similarity between the appellant and a local authority acting in a non-business capacity. Had the appeal been permitted to proceed, it would have been dismissed.

What is not clear is how a company that made no VAT returns, and only made exempt supplies, could have incurred a VAT liability of £88,000.

First-Tier Tribunal (TC08360): *Flying Spur Ltd*

An individual was assessed to VAT of £22,194 on 4 October 2013 and to a related penalty of £13,942 on 20 December 2013. He appealed on 16 May 2019, and his application to be allowed to appeal out of time came before Judge Popplewell on 28 February 2022.

The judge examined the history of the assessment, and noted that the appellant had changed his advisers four times over the period. He expressed sympathy on the basis that, on the evidence presented, he did appear to have been badly advised; however, on the basis of the decision in *Katib*, reliance on an adviser could not be a sufficient excuse for bringing a late appeal, and the factors in the *Martland* decision weighed against allowing the appeal to proceed. The application was dismissed.

First-Tier Tribunal (TC08418): *Darren Fitzpatrick*

6.8.5 Strike-out

The FTT had refused to strike out an appeal in a MTIC case about refusal of £214,386 of input tax. HMRC had argued that the appeal had no reasonable prospect of success. There was also a second, live appeal against a separate decision to deny zero-rating on certain supposed despatches to the Republic of Ireland, where HMRC had not applied for strike-out. The decisions dated from 2016 and the company had appealed in early 2017.

The strike-out hearing came before Judge Brannan in the FTT on 7 December 2020. In the decision, released on 29 January 2021, the judge refused HMRC's strike-out application, and also refused the company's application to adduce additional evidence. HMRC appealed against this decision to the Upper Tribunal (Mr Justice Edwin Johnson and Judge Andrew Scott). They argued that the judge had reached a decision that was perverse, he had misapplied the law, and he had failed to give sufficient reasons.

The UT gave a brief history of the business and the dispute as far as it was relevant to the strike-out decision. The company manufactured road tankers, but had started a separate business of dealing in second-hand cars, which had been investigated for connection with VAT evasion. Following the appeal, the FTT issued a number of procedural directions, some of which were not complied with by HMRC.

Judge Brannan had cited several authorities on striking-out applications. The UT noted a precedent that suggested the UT should exercise extreme caution in interfering with case management decisions of this sort. However, counsel for HMRC argued that a strike-out decision was more than case management, in that it was effectively a summary decision of the case. He suggested that the UT might take the opportunity of giving guidance to the FTT on how to deal with strike-out applications under Rule 8(3)(c); the UT declined to do so. It would only consider whether the judge's decision was wrong in law, and whether it should be set aside.

HMRC's argument was that the company had put forward no real answer to any of the four issues that have to be proved in a MTIC case:

1. There had been a tax loss.
2. The tax loss was occasioned by fraud.
3. The company's transactions were connected to that fraudulent tax loss.
4. The company knew or should have known that its transactions were so connected.

If the company had no answers, it could not possibly succeed. Before the UT, HMRC's counsel argued that the judge had failed to engage with this argument. The UT examined the judge's explanation for his decision not to strike out the appeal, and essentially agreed with HMRC's counsel: the judge had not engaged with the case, and had not explained why. The UT was careful to consider the situation as it had been at the time of the FTT hearing, and noted that the company had now accepted HMRC's case on issues (1) to (3). Even if the judge had only had to consider issue (4), his reasoning was inadequate.

Turning to the specific grounds of appeal, the UT did not wish to label the judge's decision "perverse", but accepted that it contained errors of law, and failed to set out sufficient reasons. The decision should be set aside; the FTT had had a considerable amount of material to consider, which meant that it was not appropriate for the UT to remake it. The case would be remitted to a differently constituted FTT. Both parties should be restricted to the evidence upon which they relied at the original strike-out hearing, unless the FTT gave permission for further evidence.

Upper Tribunal: *HMRC v Tasca Tankers Ltd*

6.9 Other administration issues

6.9.1 Lawsuit against directors

The liquidators of a company sued its directors for damages and compensation in relation to failures to account correctly for PAYE, NIC and VAT, with the result that the money the company should have paid to HMRC was instead paid to other people, leading to the company's insolvency. The total amount owed to HMRC was stated in the High Court to be over £36 million.

The company had been incorporated in March 2017 and was put into provisional liquidation on 29 July 2020, on the application of HMRC. It operated as an umbrella company in the healthcare field. The liquidator applied for summary judgment against the defendants, which the High Court judge had to be treated with caution. He gave a very detailed and lengthy decision examining the actions of various parties and evidence of what happened to the money. He was satisfied that summary judgement was appropriate and gave detailed decisions about interim awards; however, he recognised that it was likely that there would have to be a supplementary hearing to determine further issues.

High Court: *Umbrella Care Ltd (in liquidation) v Nisa and others*

6.9.2 Director's liability

A company went into creditors' voluntary liquidation (i.e. insolvent) in May 2014, after a dispute over input tax claims of £2.1m on trading in mobile phones in 2005/06. The liquidator applied for a contribution from the director to the company's assets on the basis that he had acted in fraudulent breach of duty or in breach of his duty to act honestly and bona fide and to exercise his powers for the purpose for which they had been conferred. She applied for contributions amounting to the misdeclaration penalties charged on the company, plus the irrecoverable input tax paid to suppliers less the profits made on the transactions, plus interest.

The High Court agreed that the director was responsible for the company's involvement in the fraud and had acted dishonestly. The liquidator was granted an award under Insolvency Act 1986 s.212 rather than s.213, which resulted in a higher award, totalling £1,785,892.

High Court: *Hall (as liquidator of JD Group Ltd) v Bhatia*

6.9.3 Failure to provide security

A pub business continued to trade after HMRC had issued a notice to deposit security, and HMRC commenced prosecution. The appellants applied for a stay of the prosecution on the basis that they were entitled to an independent review, and that prosecution was an abuse of process. A magistrate decided not to stay the prosecution, and the appellants appealed to the Administrative Court. The court held that the first instance judge had been correct in concluding that HMRC were not required to carry out an independent review, and as they had not created any legitimate expectation that a review would be conducted, there was no abuse of process. The appeal was dismissed.

High Court: *Pugsley and another v Director of Public Prosecutions*

6.9.4 Extradition

The High Court dismissed a renewed application for permission to appeal against extradition to Germany on a European Arrest Warrant in connection with tax evasion amounting to €3.5million in German VAT. The appellant contended that extradition would be contrary to his rights under art.8 of the European Convention on Human Rights, but the judge considered that there was no realistic prospect that a substantive appeal hearing would come to a different decision from the first hearing.

High Court: *Haberlin v District Court Hamburg Germany*

6.9.5 Financial Guardians in Scotland

On 21 September 2021, the Office of the Public Guardian (Scotland) announced that the sum of remuneration awarded to financial guardians would be treated as inclusive of VAT, and the addition of VAT to fee claims from professional guardians would not be approved from 1 November 2021.

On 10 January 2022, following discussions with the Law Society’s Mental Health and Disability Sub-Committee, the OPG has agreed that professional financial guardians can continue to claim VAT in addition to the sum of remuneration awarded, and it will be approved by the office. The OPG acknowledged the valuable work financial guardians carry out for incapable adults across Scotland who have no family members able to step into this role and acknowledged that the role of a professional guardian was different from that of a family member.

www.publicguardian-scotland.gov.uk/general/news/2022/01/10/attention-all-professional-financial-guardians