VAT UPDATE
OCTOBER 2019

Covering material from July – September 2019

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VAT Update October 2019

Contents

1. INTRODUCTION

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

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

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

1.1 Appeals pending

It is not possible to compile a comprehensive list of cases under appeal, and some of those which are thought to be still "live" may be dropped without a hearing. The following is compiled from several sources, and is just an approximate guide to some of the arguments that do not appear yet The HMRC website section which reports the progress of appeals reappeared on 21 January 2011 after lying dormant for some time. It says that it will be updated monthly, but it appears to be less frequent or regular than that. The latest update appeared on 17 May 2019 after a gap since 26 February; it appears to have been updated again on 13 June with minor amendments, but that would mean there has been no update of the list in the quarter to 30 September 2019. Nevertheless, there do appear to be some changes to the list that appeared in the last update.

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

- *Alan McCord*: HMRC granted leave to appeal against the FTT decision that a car dealer was entitled to input tax on cars purchased for domestic sales, but denied input tax on cars purchased for sale to customers in the Republic of Ireland.
- *Blackrock Investment Management (UK) Ltd*: argument about application of reverse charge to software bought in for use in management of investment funds – UT dismissed HMRC's appeal on the "exemption" issue but referred the "apportionment" issue to the CJEU.
- *DCM (Optical) Ltd*: both sides have been granted leave to appeal to the Court of Session against the Upper Tribunal's decisions in relation to apportionment of sales between taxable and exempt supplies (not on HMRC's list).

- *Done Brothers (Cash Betting) Ltd and others*: HMRC have been granted leave to appeal against the FTT decision that the company was entitled to exemption of its gaming supplies on fiscal neutrality grounds.
- *Hastings Insurance Services Ltd*: HMRC have applied for leave to appeal the FTT decision on place of establishment (UT hearing scheduled for 7 October 2019).
- *Jigsaw Medical Services Ltd*: company has been granted leave to appeal against UT's decision denying zero-rating of their ambulance services as "passenger transport".
- *LIFE Services Ltd/Learning Centre (Romford) Ltd*: the companies have been granted leave to appeal to the CA against UT's decision that their supplies did not qualify for the exemption for welfare.
- *Newey (t/a Ocean Finance)*: HMRC describes the CA decision as a "partial win for HMRC". The case has been remitted to the FTT for further consideration in the light of the CJEU judgment (hearing listed for June/July 2019).
- *Northumbria Healthcare NHS Foundation Trust v HMRC*: CA to hear HMRC's appeal against UT decision that provision of cars under a salary sacrifice scheme could not be regarded as a supply of services, so the Trust was entitled to claim VAT on leasing in full under s.43 (not on HMRC's list).
- *Opodo Ltd*: HMRC seeking leave to appeal to the Upper Tribunal (against FTT decisions that do not appear to have been published yet – HMRC seeking a reference to the CJEU).
- *Pacific Computers Ltd*: MTIC case remitted by the UT to differently constituted FTT for rehearing (not on HMRC's list).
- *Praesto Consulting UK Ltd*: HMRC seeking leave to appeal against the CA decision in favour of the company's deduction of input tax on legal costs.
- *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).
- *Rank Group plc*: HMRC has been granted leave to appeal against the FTT decision that certain supplies qualified for exemption on fiscal neutrality grounds (the separate decision on *Rank* in this update relates to a different question).
- *The Core (Swindon) Ltd*: HMRC are seeking leave to appeal against the FTT decision that certain products were "liquid meal replacements" rather than "beverages".
- *The Ice Rink Co Ltd and another*: the UT remitted the case to the same FTT for reconsideration of whether the supply of children's ice skates was a separate zero-rated supply or part of a compound supply.
- *The Wellcome Trust Ltd*: HMRC granted leave to appeal against the FTT decision that the company was not subject to a reverse charge on

investment management fees. The UT has agreed to refer questions to the CJEU (covered in this update).

- *Volkswagen Financial Services Ltd*: HMRC are still considering the CJEU judgment on the partial exemption issues.
- *Zipvit Ltd*: (not on HMRC's list) taxpayer has been granted leave to appeal to the Supreme Court against the CA confirmation of decisions below that the company could not claim input tax on the VAT element of payments to Royal Mail without a VAT invoice, even though it was clear that taxable supplies had been made.

1.2 Decisions in this update

The following cases from HMRC's list are in the current update:

- *Frank A Smart & Son Ltd v HMRC*: HMRC have been granted leave by the Supreme Court to appeal the CS decision in the taxpayer's favour on the deductibility of input tax on the cost of single farm payment entitlements. HMRC will seek a reference to the CJEU on the same point as that at issue in the *University of Cambridge* case.
- *Pertemps Ltd*: HMRC will appeal against the FTT decision that the company's "mobile advantage plan" for employee travelling expenses did not involve making taxable supplies (hearing scheduled for July 2019).
- *The Chancellor, Masters and Scholars of the University of Cambridge v HMRC*: CA has referred questions to CJEU (Case C-316/18) on deductibility of investment management costs where an endowment fund supports the whole of the university's activities.

2. OUTPUTS

2.1 Scope of VAT: linking supplies to consideration

2.1.1 Article

In an article in *Taxation*, Julie Butler considers the VAT implications of selling a horse or a share in one. This is particularly important for an individual owner who is registered for VAT in relation to another business activity – if the horse ownership is "economic activity", it will be covered by the registration even if the amounts are below the threshold on their own. The article considers the tests of economic activity and the issue that the sale of an undivided share in the horse is a supply of services rather than a supply of goods.

Taxation, 11 July 2019

2.2 Disbursements

Nothing to report.

2.3 Exemptions

2.3.1 Insurance related services

A company appealed against a June 2013 ruling that it was making taxable supplies and should be registered with effect from 1 June 2009. The company's business was to assist consumers to make PPI claims. It made cold calls and entered into contracts with those customers who agreed to be represented, in return for a fee of 39% of the compensation received.

The company argued that its contracts gave it the right to terminate a customer's inappropriate insurance policies from the outset, and that on the basis of *Lubbock Fine* (which concerned termination of a lease) the termination of insurance policies involved "insurance transactions". The judge considered the analogy with the leasing case to be misconceived. That decision held that the consideration for the termination was exempt; in this case, the analogy would be with the payment of compensation, not the service of assisting with the claim.

In support of the conclusion that this was not a supply of "insurance transactions", the judge commented that the customers would not have considered the service to be "terminating insurance". Throughout the documentation, it was referred to as assisting with a claim for compensation. That was also how the business was described in a VAT registration application dated 26 November 2009. Some of the contracts had already long expired, which meant that the company could not terminate them – its services on expired and unexpired policies were effectively identical.

The second question was whether the company was supplying insurance related services of an insurance agent or broker. This involved consideration of Directive 77/92/EEC, *Re Forsakringsaktiebolaget Skandia* (Case C-240/99) and the 2010 Court of Appeal decision in *InsuranceWide.com v HMRC*. Whether or not a person is an insurance broker or an insurance agent depends on what they do. How they choose to describe themselves or their activities is not determinative. The definitions in the Insurance Directive were relevant, but only to the extent that they reflected legal reality and practice in insurance law; they would not determine the outcome of a VAT case. CJEU cases have held that it is an essential characteristic of an insurance broker or an insurance agent for VAT purposes that they are engaged in the business of putting insurance companies in touch with potential clients or, more generally, acting as intermediaries between insurance companies and clients or potential clients.

The judge did not consider that the company had these characteristics. Although it acted as an agent for its customers, it did not "put them in touch" with the insurance companies, even when making a claim – they already had, or had in the past, insurance policies with those companies. Nor did the UK law, which exempts "assistance in the administration of contracts of insurance, including the handling of claims", assist the appellant. That was not a proper description of the service: it was not making a claim under the policy, but a claim against the insurer in relation to unfair contract terms.

The judge also considered whether the services related to insurance transactions. The 2001 High Court precedent of *Century Life* was cited. That concerned an insurance company considering whether pensions policies had been mis-sold: the HC judge held that involved the detailed consideration of whether the policy had been suitable for the customer, and that was an insurance-related service. The FTT judge did not consider that the situations were similar. The company dealt with claims for compensation in relation to contracts that had usually expired, and were usually then held to have been void from the outset. That involved consideration of compliance with regulations in the selling of the policy, but it was quite different from the assessment of the suitability of an ongoing pension contract as in *Century Life*.

The appeal was therefore dismissed.

First-Tier Tribunal (TC07308): *Claims Advisory Group Ltd*

2.3.2 Payment services

AESEL is a member of the American Express corporate group. It issues Amex cards to customers who use them as a form of payment for goods and services; in that connection, it made supplies of payment services. There was no doubt that it made such supplies to a member of the Amex group, but HMRC and the taxpayer did not agree which company was the recipient of the supplies. If it was a company established outside the EU, as the company argued, it was entitled to input tax credit; it had claimed £57m between 12/10 and 12/14. HMRC argued that it made its supplies to an EU company, and the supplies were therefore exempt without credit for input tax.

The judge noted that it was common ground that the services were exempt and capable of being "specified supplies", and that the places of establishment of the two possible recipients were respectively inside and outside the EU. The only issue, therefore, was which of the two companies received the supplies. The judge listed a number of precedents from *Loyalty Management* to *Adecco*, but noted that the Supreme Court judgment in *Airtours* was now the fundamental precedent. The UT in *Adecco* had summarised the principles established by that case as a "two stage process" to identify the nature of a supply and who is making and receiving it:

"The starting point is to consider the contractual position and then consider whether the contractual analysis reflects the economic reality of the transaction. If, as a matter of contract, a party undertakes to provide services to another person in return for consideration from the other or a third party then there is, subject to the question of economic reality, a supply to the other person for VAT purposes. If the person who provides the consideration is not entitled under the contractual documentation to receive any services from the supplier then, unless the documentation does not reflect the economic reality, there is no supply to the payer. The contractual position normally reflects the economic reality of the transactions but will not do so where, in particular, the contractual terms constitute a purely artificial arrangement."

The company that HMRC argued was the recipient of the supplies, AEPSL, was a merchant acquirer operating in the UK. It dealt with merchants who accept or agree to accept Amex cards. The company contended for by the appellant, TRSCo, is the main operating entity within the Amex group. It owns the key trademarks and other IP that are required to conduct the card business. It also owns the great majority of the systems infrastructure and employs or procures the services of the people necessary to maintain the systems. TRSCo has agreements with issuers and acquirers (except in the US where TRSCo is itself both issuer and acquirer in relation to some transactions).

The Tribunal examined the contracts between AESEL and TRSCo, and the way in which those contracts were operated in practice, including the way in which charges were levied and settled. To illustrate the position, a single card transaction in a period for £100 that resulted in an AEPSL merchant owing a fee of 3% to AEPSL would create the following liabilities:

(1) AESEL owing TRSCo £98.44 (the £100 spend net of the billing credit of £1.56); and

(2) TRSCo owing AEPSL £98.10 (the £100 spend net of the billing debit of £1.90).

(3) AEPSL owing the merchant £97 (the £100 spend net of the 3% fee).

In terms of consideration charged and retained, AEPSL charges the merchant £3 and retains £1.10 after paying the billing debit to TRSCo; TRSCo charges AEPSL £1.90 and retains £0.34 after paying the billing credit to AESEL; and AESEL charges and retains the billing credit of £1.56.

HMRC argued that the contract between AESEL and TRSCo referred to TRSCo acting "on behalf of the acquirer" (AEPSL) in clearing and presenting charges for acceptance and payment by AESEL. In their view, therefore, the true recipient of AESEL's supplies was AEPSL. HMRC's counsel did not propose that the contract made TRSCo AEPSL's agent, but the words "on behalf of" were nevertheless enough to "deflect the supply". The judge described this as "an astonishing proposition". "*It would mean that, even where no agency relationship existed, the parties to an agreement to supply services could nominate who was to be treated as the recipient of the supply at will. That would open the door wide to avoidance and, in our view, such a construction should not be accepted unless no other were possible.*" The judge was satisfied that the contractual position was that AESEL made its supplies to TRSCo.

The judge went on to consider what was meant by "economic and commercial reality" in accordance with various precedents, in particular *Newey*. The Court of Justice did not refer to all the matters of fact mentioned in that case's reference but focussed on two elements, namely where were the services effectively used and enjoyed and who benefited from them. HMRC's counsel tried to persuade the judge that the corporate relationships meant that the true recipient of the supplies was AEPSL.

The judge did not agree: "*We find that the role of TRSCo is central to the operation of the American Express card business. Mr Hough's evidence, which we accept, was that the presence of TRSCo at the centre of the supply chain provides valuable benefits to the Amex Group. TRSCo is able to ensure that common standards and practices, including the capture of the right transaction data, are applied across the card network. In Mr Hough's opinion, TRSCo's role is central to the operation of the network and the ability of cardmembers to use their cards globally to purchase goods and services. We find that, in that role, TRSCo also acts as a clearing house providing clearance and settlement services to issuers and acquirers. In order to give effect to those services, TRSCo requires and receives payment services from AESEL.*" In short, the commercial and economic reality was the same as the contractual position.

The appeal was allowed.

First-Tier Tribunal (TC07342): *American Express Services Europe Ltd*

2.3.3 Education exemption

HMRC have updated their Notice *Education and vocational training* to include higher education providers registered in the appropriate category with the Office for Students in the list of 'eligible bodies' for the purposes of the exemption from VAT. The law changed with effect from 1 August 2019.

Notice 701/30

HMRC have also issued a Brief to explain the rule changes in more detail, following on from *Brief 11/2018*. Higher education providers in England are required from 1 August 2019 to be registered with the Office for Students in the 'Approved (fee cap)' category under the Higher Education and Research Act 2017. The exemption will not be backdated for bodies that have not registered by 1 August.

R&C Brief 5/2019

2.3.4 Medical care

A company appealed against rulings that Botox injections and nail fungus treatment were not exempt under Sch 9 Group 7, and consequent assessments for the periods from 05/13 to 11/16 totalling £21,064. HMRC had initially picked up a discrepancy between turnover reported for corporation tax and the VAT returns; the company had incorrectly omitted turnover that it regarded as exempt from the VAT returns. This explanation was accepted, but HMRC disputed the application of the exemption.

The company argued that:

(1) Botox is a medical procedure and SRL employs members of the medical profession to administer and supervise it in all instances; and

(2) nail fungus treatment is also a medical treatment as it is carried out to restore the health of the person concerned, and GPs now advise their patients to seek private practices as the NHS is over-stretched.

At a late stage, the appeal was extended to cover "dermal fillers", as HMRC's decision extended to all "injectable treatments". The company claimed exemption for injectables under Items 1 and 2 of Group 7 (medical care provided by registered medical practitioners) and for the fungus treatments under Item 4 (which covers provision of care or medical or surgical treatment in a hospital or state-regulated institution).

The Tribunal considered the credentials of the practitioners who carried out the treatments, and heard evidence from one doctor who was the only one providing injectables. She cited patient case studies and put forward medical reasons for the need for treatment, including psychological benefits. Nail fungus treatment was provided by persons not on an appropriate register, so Items 1 and 2 could not apply.

The company argued that the practitioners who provided injectable treatments were appropriately qualified, and that the treatments were medical care rather than purely or mainly cosmetic in nature. The CJEU had held that cosmetic treatments were capable of being exempt in *Skatterverket v PFC Clinic AB* (Case C-91/12). It further argued that it was state-regulated in that the local council had granted it a licence as a "health and beauty clinic" under the Town and Country Planning Act 1990.

The Tribunal considered the history of the law in this area. HMRC had considered that all services of medical practitioners were exempt, but following the *d'Ambrumenil* decision of the CJEU (Case C-307/01), Group 7 was amended to restrict the exemption to "medical care". That would be interpreted in line with the CJEU decision to cover the diagnosis and treatment of a patient for the protection, maintenance or restoration of health, and to exclude medical procedures that were carried out for some other purpose, for example in relation to litigation.

HMRC argued that the appellant had the burden of proving a medical need for the treatments. The patients were not referred by their GPs; the evidence (according to HMRC) indicated that they were mainly interested in the cosmetic outcome. Further, the company was not registered with the Care Quality Commission, which was the relevant "state regulation" for hospitals and similar institutions. There was no evidence that the local council actually regulated the nail fungus treatments in any way.

The judge summarised the essential argument as follows: "In order to constitute the provision of medical care, SRL must establish that the principal purpose of the Injectables treatments for which exemption is claimed is to diagnose, treat or cure diseases or health disorders, or to protect, maintain or restore human health." The facts that it held a council licence and medical liability insurance were not relevant to this question. The evidence was insufficient to satisfy the burden of proof on the appellant to show that the treatments were mainly therapeutic in nature.

That was enough to deny exemption under Items 1 and 2, but the Tribunal also considered the other conditions of those Items. This involved consideration of the registrations of various specific health professionals, and conflicting arguments that a registered practitioner had to be specifically qualified in the type of care provided (HMRC) and that any registered practitioner could qualify for exemption in relation to any medical care (the appellant). The judge held that the correct answer was between the two: it could not be right that an osteopath could be considered appropriately qualified to act as a midwife, but it did appear that a dentist with suitable training could provide the injectable treatments within the exemption (if, and only if, they constituted medical care).

The Tribunal decided that the words of Item 4 ("care or medical or surgical treatment") were wider than "medical care" in Items 1 and 2, and the decision that the injectables were mainly cosmetic therefore did not necessarily rule out exemption under this heading. The precedents of *Christoph-Dornier-Stiftung fur Klinische Psychologie v Finanzamt Giessen* (C-45/01) and *Diagnostiko & Therapeftiko Kentro Athinon-Ygeia AE v Ipourgos Ikonomikon* (Joined Cases C-394/04 and C-395/04) were considered to establish the following principles:

(1) services fall within the concept of an activity closely related to hospital or medical care only when they are actually supplied as a service ancillary to the hospital or medical care received by the patients in question and constituting the principal service;

(2) a service can be considered to be ancillary to a principal service where it constitutes not an end in itself but a means of enhancing the enjoyment or benefit of the principal service supplied by the provider;

(3) only the supply of services which are logically part of the provision of hospital and medical-care services, and which constitute an indispensable stage in the process of the supply of those services to achieve their therapeutic objectives is capable of amounting to closely related activities within the meaning of that provision; and

(4) the provision of services which are of such a nature as to improve the comfort and well-being of in-patients do not, as a general rule, qualify for the exemption. It can be otherwise only if those services are essential to achieve the therapeutic objectives pursued by the hospital services and medical care in connection with which they have been supplied.

The Tribunal concluded that the injectable treatments were "medical treatment" and were capable of constituting "care", even if not "medical care". This went against the Tribunal's decision in *Ultralase Ltd*, but that had not considered the question in the same way. The lack of any referrals from GPs, or other evidence of a medical need, undermined the company's case that the nail fungus treatments (using a laser) were "medical treatment".

The final conclusion was that the council licence did not constitute "state regulation" for the purposes of the Group. This meant that:

- the injectables were not "medical care" (for lack of evidence of therapeutic purpose) but could be "medical treatment", but they were not carried out in a state regulated institution;
- the nail fungus treatments were not administered by a registered professional and were not "medical treatment" (for lack of evidence), and were not carried out in a state regulated institution.

The appeal was dismissed.

First-Tier Tribunal (TC07310): *Skin Rich Ltd*

2.3.5 Staff or services?

A company claimed that it was supplying medical care through pharmacists to various GP practices. HMRC ruled that it was supplying staff, and raised assessments for the periods from 12/16 to 09/17 totalling £34,721.

The Tribunal was satisfied that the work done by the pharmacists constituted medical care. The question was whether that care was being provided by the company that employed them, or whether they were supplied as staff to the GP practices which supplied the care. The Tribunal considered precedents including *Moher* (UT 2012), *Rapid Sequence Ltd* (FTT 2013) and *City Fresh Services Ltd* (FTT 2015). The first two had been decided in HMRC's favour (staff supplies, not medical care, because the staff were under the control of the client practice or hospital); the third was an unusual situation in which a dental partnership decided to make its supplies through a company, so the dentists who were supplied by the partnership were supplying all the medical care.

The Tribunal did not consider that the precedents were particularly close to the facts of the present case, but they helped to set out relevant principles. These were:

(1) A supply by a non-natural person to another non-natural person may still be a supply of services consisting in the provision of medical care.

(2) It is necessary to look at all of the relevant facts and not just the contractual provisions.

(3) One of the most important factors is who controls or supervises the activities of the relevant individual(s).

With those principles in mind, the Tribunal examined the history of the business and how it operated. It had originally supplied locums to doctors' practices; in 2015/16 it had developed a new business line involving "pharmacist-led clinical services", which were intended to help patients derive maximum benefit from their prescribed therapies while reducing medication-related risks and improving pharmaceutical care services. These two strands of business were operated quite separately.

The director of the company explained that the new business differed from the old in that the pharmacist was not replacing a member of the practice, but providing a service that had not previously existed. This might replace some things that a doctor might have done, freeing up their time, but in the main was a distinct and new service. In his view, the contracts provided for the company to have sufficient control and supervision of the staff it provided to qualify as supplies of services, not staff. He produced a number of sources of evidence to support this argument.

The judge commented that there were factors in the case that pointed both ways. There was no "bright line" to distinguish a supply of services from a supply of staff; the answer lay in the grey area between *Moher* and *City Fresh*. However, on balance, the Tribunal concluded that the supply fell on the side of being exempt services rather than taxable staff. The way in which the business was organised had "more of a flavour of the provision of a service"; the company made a bespoke proposal to the GP practice to meet its particular needs. The fact that it then billed by pharmacist hours did not mean that it was supplying staff – that simply reflected the fact that the practice would be working to a budget.

There were other factors supporting the conclusion – regular onsite reviews and insurance, apparent clinical responsibility for the pharmacists' decisions, and the requirement to meet key performance indicators. There were also some factors indicating the other way, including the day to day allocation of tasks. Several of the factors put forward by HMRC were regarded as neutral, such as the ability of the practice to request more hours and the payment of a recruitment fee if the pharmacist became an employee of the client practice.

The appeal was allowed.

First-Tier Tribunal (TC07370): *Medacy Ltd*

2.3.6 Exemption confirmed

A charitable trust appealed against a decision by HMRC that its supplies were exempt as "welfare services". The judge noted that the result of HMRC's decision would be that the appellant would be due a repayment of £400,000 in net overpaid output tax. It appears that the Trust's customers were local authorities, so it would lose the right to recover input tax without being able to reduce its effective charges to its customers.

HMRC had confirmed in December 2004 that it regarded the trust's services as taxable, but reversed this following a request for a non-statutory clearance in March 2015. The reason for that request was a planned construction project on which the Trust intended to reclaim input tax.

The Trust's service is supplied to local authorities in connection with decisions about putting children on the Child Protection Register or taking them into care. The chief executive of the Trust argued that the focus of the services was the parents, and that the Trust did not provide any care to children. However, the assessment was carried out at a residential centre where the quality of a parent's care could be observed.

The Tribunal examined the Trust's services and its history, and considered the EU and UK legislation and VAT Notice 701/2. The 2011 version of the Notice specifically includes "assessment of families to be included on the at risk register by providers mentioned in section 3 [which includes charities]" as an exempt supply, being "services directly connected with the care or protection of children and young persons".

The Trust argued that there was only an indirect connection between its services and the care and protection of children. There were several intervening factors and intermediaries between the service provided and that care and protection. It argued that its main supply was welfare advice and information, which carried a lower rate of 5%, and any actual welfare service was an incidental part of that main supply.

HMRC argued that the nature of the supply was directly connected to care and protection, given that it assessed children at risk in supervised accommodation and made reports that were the basis for decisions on child protection. The fact that it did not itself make the decisions did not mean that the service was not "directly connected".

The judge started by noting that the Trust had only registered in the first place because HMRC had told it to, and it had paid a late registration penalty. She agreed with the decision in *YMCA Birmingham* that the fact that the recipient of the supply was the local authority did not stop the supply being one of welfare services if it was connected to the protection of children. She also accepted HMRC's argument that the UK legislation's wording ("directly connected") had to be interpreted in a manner consistent with the EU wording ("closely related"). The Trust's attempt to use dictionary definitions to pick apart "directly connected" therefore did not succeed.

In summary she found that the "essential purpose" of the supplies made by the Trust was to ensure that the child is better cared for and has optimal protection, and that was both closely linked and directly connected with the protection of children and also to their care. The alternative description of its supplies as "welfare advice" could not be supported, because Sch.7A excludes "advice provided solely for the benefit of a particular individual or according to his personal circumstances" – that was exactly what the Trust did.

The appeal was dismissed.

First-Tier Tribunal (TC07346): *The Lilias Graham Trust*

2.3.7 Cost-sharing exemption

Following the 2017 CJEU decisions on the cost-sharing exemption, in particular *DNB Banka AS* (Case C-326/15), HMRC issued R&C Briefs 3/2018 and 10/2018 explaining that they would change their policy (although not the law) to restrict the application of the cost-sharing exemption to bodies that were exempt by reason of one of the categories in art.132 PVD. This was because the CJEU had ruled that the CSE was only intended to apply to "public interest exemptions", not to exemptions in general.

The position of housing associations was left under consideration. Although their income is exempt under art.135, they are similar to many of the entities that would be exempt under art.132. Now HMRC have confirmed that they will retain the application of the CSE to cost-sharing groups set up by housing associations defined in section one of the Housing Associations Act 1985 and other registered social landlords who provide social housing for the benefit of the community, on a not-for-profit basis (as well as the equivalent bodies in Scotland and Northern Ireland). It will not apply to arrangements entered into by private landlords.

The Brief sets out the following additional conditions for the CSE to apply to a group set up by housing associations:

- there must be no uplift of internal or external costs (for example, resulting in a margin or profit on actual costs being recharged) within the CSG;
- there must be no uplift of the costs being shared within any VAT group including either, the CSG itself, and or the members of the CSG;
- there must be no uplift of costs by a VAT group member supplying a CSG in the same VAT group;
- there must be more than one member of the CSG, the count does not include members that are in a VAT group either with the CSG, or with other members;
- the CSG only applies to providers of social housing (registered social landlords) and not to private housing providers.

The Cost Sharing Exemption Manual will be updated to reflect the new policy.

R&C Brief 8/2019

2.4 Zero-rating

2.4.1 Books etc.

A sole trader sold a product called the "Action Day Planner". HMRC ruled that the product did not qualify for zero-rating and issued a decision that he should be registered with effect from 26 July 2013, together with assessments to tax and penalties. He appealed, and the Tribunal had to consider whether the product was in fact eligible for zero-rating.

The trader operates from his home in Iceland, selling goods through the Amazon marketplace. HMRC began a routine check on non-established taxable persons in July 2017 and concluded that he should have been registered from his first sale into the UK (as non-established persons do not have a registration threshold). The trader had applied for registration on 4 July 2017, but he considered that no VAT was payable.

The assessments covering the long registration period from July 2013 to 30 June 2017 was £158,000, with another for £12,770 for the 08/17 period, and a late notification penalty of £33,189 and an inaccuracy penalty of £1,915 were later added.

The Tribunal examined an example of the product, which is between A4 and A5 in size and contains 115 pages. It is described as a time management tool developed to "help people to grow; to teach and instruct people time management skills". It is an interactive tool intended to facilitate the discipline of time management, step by step building habitual behaviour. The first 16 pages of the ADP contain text setting out a narrative of the ethos articulated by the Appellant for effective time management following themes of "attitude", "goals" and "actions" together with the "discipline of rituals". The remainder of the ADP is taken up with 52 double page planners. The layout follows the methodology advocated in the first 16 pages with space to set out "tasks to execute" "delegation and teamwork" a column for each day of a week and "goals/projects I am going to work on this week". The columns for each day represent a little over one quarter of each double page.

HMRC's view was that this was essentially a stationery item similar to a diary or an address book. VAT Notice 701/10 contains a discussion of the difference between "stationery" and "books that qualify".

The Tribunal considered the precedents of *Colour Offset Ltd* (HC 1995) and *Tudor Print and Design Ltd* (VTD 17848). In both cases the courts confirmed Customs' decision that the products were mainly intended to be written in, and were therefore stationery.

The appellant appeared in person, and presented an analysis of the items that are regarded as zero-rated according to Notice 701/10. In particular, some products that are intended to be written in are zero-rated. HMRC's representative could not explain why HMRC regard GCSE revision aids and crossword books as zero-rated when writing in them is a significant purpose of the product.

The Tribunal noted that the product had to be a "book" to qualify at all; it was then necessary to consider whether it was excluded as "stationery". The product had the characteristics of a book – hard covers and pages. The judge noted that the purpose of the section at the front did appear to be to impart information; if there had only been a single template for the planning section, which the purchaser would have to photocopy to apply the lessons learned, there would be little doubt that the product would be zero rated. After much debate, the Tribunal decided that the fact that there were 52 copies of the template did not change the main function or purpose of the product to that of a diary. It was no different from a crossword book or exam revision guide. It qualified for the zero rate.

This meant that the assessments fell away. In theory, the trader was still liable for registration, as he had not applied for exemption on the grounds that his supplies were all zero-rated; however, the penalty for failing to register was tax-geared, so there was no penalty to pay. The appeal was allowed.

First-Tier Tribunal (TC07255): *Thorsteinn Gardarsson*

2.4.2 Animal feeding stuffs?

A company sold a product that contained grass seed and other materials to promote the growth of the seed. It claimed zero-rating on the grounds that this was "seed for growing grass for animal feed". The liability dispute was backed up with an assessment for £588,882 for periods from 10/11 to 03/15.

It was accepted that the product was a single supply rather than a range of separable elements. The Tribunal considered that the proper approach was to make a multi-factorial assessment to consider whether or not the product was seed for grass for animal feed. This had to include how the product was objectively held out for sale by the appellant.

The capacity for a product to be a foodstuff is not enough on its own to make it so (see *Fluff Ltd (t/a Mag-it) v C&E* [HC 2001] and *HMRC v Roger Skinner Ltd* [UT 2014]). HMRC's Notice 701/38 states that "Most grass seed is zero-rated because of the extensive use of grass as animal feed. This includes supplies to and by garden centres, local authorities and grass seed to be sown on set aside land." However, it was clear that the product was marketed for domestic use on lawns and was not held out in any way to be suitable for the purposes of growing animal feed. Advice had been requested from Cambridgeshire County Council in relation to the product, describing it as a "lawn repair product". The fact that it contained generic grass seed, which on its own was likely to be zero-rated, was overridden by the way in which the product was marketed.

The Tribunal rejected an argument based on fiscal neutrality. The grass seed represented less than 10% of the product by weight; the fact that it contained an element that on its own would be zero-rated did not determine its nature or its liability.

The appeal was dismissed.

First-Tier Tribunal (TC07283): *Westland Horticulture Ltd*

2.5 Lower rate

2.5.1 Energy saving materials

HMRC have updated their Notice *VAT on energy-saving materials and heating equipment* to reflect changes taking effect from 1 October 2019, which includes the introduction of a new 60% test in relation to cost of materials where social policy conditions are not met. This is described as follows:

[The business] must first establish the price that it paid to purchase the materials (excluding VAT) used in the installation and calculate this as a percentage of the total value of its supply (excluding VAT) to its customer. The materials that must be included in this calculation are all of the goods supplied to the customer as part of the installation which remain in place once the job has been completed.

For example, a business installs insulation in a residential property. It pays £400 (excluding VAT) for the insulation material and charges its *customer £1,000 (excluding VAT) for the installation. Since the cost of the materials to the business is only 40% of the value of the supply that the business makes to its customer, the business can charge the reduced rate of 5% on the total supply, that is 5% of £1,000 = £50.*

However, where the 60% threshold is exceeded (that is, where the percentage is 61% or more using normal rounding conventions), the business will need to carry out an apportionment. This requires the business to apportion the value of the total supply that it makes to its customer, between materials (which will be standard rated) and labour (which will be reduced rated).

For example, a business carries out an installation of solar panels combined with a battery. It pays £5,000 for the solar panels and battery (excluding VAT) and charges its customer £7,500 (excluding VAT) for the installation. Since the cost of the materials to the business is 67% of the value of the supply the business makes to its customer, the 60% threshold is exceeded. This means that the business will need to separately identify the value of the materials supplied to its customer and charge VAT at the standard rate on the supply of those materials. The labour element of the supply will continue to qualify for the reduced rate.

HMRC have also published a Tax Impact and Information Note Changes to VAT reduced rate for energy-saving materials explaining the background to the measure (the need to comply with a 2015 EU ruling) and stating that the effect on the Exchequer will be negligible.

Notice 708/6; *www.gov.uk/government/publications/vat-changes-to-the-reduced-rate-for-energy-saving-materials-2019*

2.6 Computational matters

Nothing to report.

2.7 Discounts, rebates and gifts

2.7.1 Price adjustments

HMRC have updated *The VAT Guide* (section 18.2) and issued a Brief to explain the new rules applying from 1 September 2019 covering changes in accounting for VAT after prices are altered. Suppliers must issue debit notes in respect of price increases and credit notes in respect of price decreases no later than 14 days after these price changes are agreed with customers. Suppliers must then account for adjustments in the VAT period in which price changes occur.

The reason for the amendment to reg.38 is explained as follows:

The [previous] rules do not impose a time limit for making VAT adjustments when price adjustments are made, but it is a requirement that the VAT must be adjusted. Failure to do so is an error which must be *corrected in accordance with requirements, and within time limits set out in the Regulations and the VAT Act 1994.*

There is evidence that some businesses are trying to use the [previous] Regulations to gain a tax advantage by making VAT adjustments for reductions in price without refunding their customers.

Some businesses also incorrectly attempt to treat errors as price adjustments for the purpose of avoiding the relevant time limits. Regulation 38 cannot be used in these circumstances. Instead the error correction procedure explained in How to correct VAT errors and make adjustments or claims *(VAT Notice 700/45) should be used. These error corrections are limited to 4 years following the time of the original sale.*

There is litigation on this topic. Recent court decisions support HMRC's view of how the law applies. The revised rules will however put it beyond doubt that Regulation 38 may only be used to reduce the amount of VAT paid to HMRC when a refund is actually made. They will also clarify when and how VAT adjustments must be made.

The new rules require a debit note to be issued within 14 days after a price increase is agreed by the supplier and the customer, and the VAT adjustment to be made in the VAT period in which the change is agreed.

More importantly, a "decrease in price" is now restricted to a situation in which a refund is paid to a customer or another person entitled to receive the payment. The supplier is then required to issue a credit note within 14 days of making the payment. It is permissible to issue credit notes in advance of making the refund, but not more than 14 days afterwards. Once again, the VAT adjustment must be accounted for in the period in which the repayment is made.

There is a definition of a payment for this purpose: it has to be a payment in money, or an offset made against an existing liability. There are also new requirements for the content of a debit or a credit note. The requirement to provide a debit note or credit note does not apply in cases where an equivalent document has been provided by the supplier to the customer prior to 1 September 2019. This will prevent the need for a second document to be issued where one has already been provided before the new rules started. Also, the requirement to make any adjustment for a change in price does not apply in cases where an adjustment has already been made under Regulation 38 before 1 September 2019.

R&C Brief 6/2019; *Notice 700*

2.8 Compound and multiple

Nothing to report.

2.9 Agency

2.9.1 Retained payments and deposits under TOMS

HMRC have issued a correction to their Notice *Tour operators margin scheme* and a Brief to explain that an error arose when it was updated in March to take into account the change of policy in relation to forfeited deposits and cancellation fees.

The March update indicated that tour operators should include all forfeited deposits and cancellation fees in their margin scheme calculations, but TOMS in fact only requires tour operators to account for such payments where they exceed 20% of the full sale price. HMRC have invited claims (using normal error correction procedures) from traders who have overpaid VAT since 1 March as a result of relying on the incorrect guidance.

The detail is explained as follows:

Businesses making TOMS supplies may choose between 2 different methods for determining when their supply becomes taxable. They can either use:

- *method 1 and account for VAT when the traveller departs or the accommodation is occupied;*
- *method 2 and account for VAT when taking payment if it exceeds 20% of the sale price – if they receive a deposit of 20% or less then the treatment in method 1 applies.*

Businesses that have chosen to use method 1 must not include money paid for supplies customers fail to take up in their TOMS calculation, as a tax point never occurs.

Businesses that have chosen to use method 2 must include money paid for supplies their customers fail to take up in their TOMS calculation where they have paid more than 20% of the price of the supply. If the customer has paid 20% or less of the price of the supply, businesses must not include the amount received in the TOMS calculation. They must treat this in accordance with method 1.

*Notice 709/*5; *R&C Brief 9/2019*

2.10 Second hand goods

2.10.1 Second-hand turnover

The PVD provides for special schemes for small businesses (art.288, allowing Member States to treat businesses below a turnover threshold to be treated as exempt) and for second-hand dealers (art.311, requiring Member States to calculate the tax on certain transactions on the profit margin rather than the full selling price). In Germany, up to 2009, a second-hand dealer's turnover for the small business scheme was regarded as the profit margin. The practice was changed for 2010; a dealer who had been treated as an exempt small business for 2009 objected to being treated as taxable in 2010, and questions were referred to the CJEU.

The court noted that the two schemes were independent of each other. Turnover for the small business scheme was not restricted to “the amount used to calculate the tax”; it had to be interpreted as the whole amount received in respect of a taxable transaction. The margin scheme operated to reduce the output tax liability on the sale of a second-hand item, but it did not change the fact that the whole of the sale was a taxable supply.

Accordingly, the original German practice had been incorrect, and the new practice could not be overturned. The dealer was a taxable person trading above the threshold.

CJEU (Case C-388/18): *Finanzamt A v B*

2.11 Charities and clubs

2.11.1 Refund scheme

HMRC have updated their Notice *VAT refund scheme for qualifying charities* with additional detail on the types of charity qualifying for the refund scheme in VATA 1994 s.33C and s.33D, namely, those concerned with the provision of palliative care, air ambulances, search and rescue, and medical couriers. The scheme allows qualifying charities to reclaim VAT incurred in respect of their non-business activities in a similar way to local authorities.

Notice 1001

2.12 Other supply problems

2.12.1 Salary sacrifice

In TC06583, a company appealed against assessments covering periods 07/09 to 07/14 totalling over £715,000, with more assessments standing behind the appeals. The dispute related to the operation by the company of a scheme for the provision of travel and subsistence expenses to employees known as a “Mobile Advantage Plan” or “MAP”.

The Tribunal set out the issues to be decided as follows:

(1) whether or not the operation of MAP involved a supply of services for VAT purposes by Pertemps to participating employees;

(2) if so, whether or not the supply was an exempt supply falling within item 1 Group 5 Sch.9 to VATA 1994;

(3) if Pertemps made a taxable supply, whether HMRC was entitled to collect the tax or whether it was precluded from doing so by the issue of Business Brief 28/11 for periods to which it applied as a result of application of its powers of collection and management. HMRC argued that the FTT did not have jurisdiction to find for the company on this ground.

The workers involved in the appeal were "flexible employees" who were guaranteed a minimum number of hours of temp work, typically 336 hours a year or 7 hours a week. They were given the option to participate in a MAP, which involved a reduction in the wages earned and a payment to the employee in respect of travel and subsistence expenses. The amount of the reduction applied to the employee's wages was equal to the amount of the expenses payment plus a fixed amount (50p or £1 per shift, the "MAP adjustment"). This was not separately identifiable in the company's accounts, but was simply reflected in the lower cost of providing workers to clients and therefore in higher profit.

The reduction in gross pay was therefore greater than the payment for travel and subsistence, but because these workers were assigned to temporary work away from their permanent workplace, the travel and subsistence payments were not taxable. The net pay was therefore greater. Steps were taken to ensure that employees for whom MAP was not suitable – for example, those for whom a reduction in wages would breach the national minimum wage requirements – did not participate in MAP or were unable to do so. HMRC had confirmed that the income tax and NIC side of the arrangement was effective.

The main benefits from the operation of the MAP scheme accrued to the employer: the cash amounts paid to flexible employees were reduced by the MAP adjustment; the employer did not have to account for employer's national insurance contributions on the MAP payment; and the employer was not required to include the MAP payment in its returns of benefits provided to employees.

The salary sacrifice arrangement had first been introduced in 2004 and had been discussed in detail with HMRC several times in the years up to 2011. That was one of the original grounds of appeal, that HMRC should not be able to question the treatment in arrears when they had effectively approved it. That ground was withdrawn before the hearing.

HMRC raised the VAT treatment of MAP at a meeting with the company on 17 October 2011. HMRC's position, as reflected in a letter dated 16 December 2011, was that, while the VAT issues had been raised and, perhaps, not followed through as promptly as might have been desirable, the question of the VAT treatment of MAP remained open. HMRC did, however, acknowledge in that letter that any disagreement over the VAT treatment was a technical one and that penalties would not be applied if any VAT was found to be chargeable as part of the review. On 17 April 2013, the relevant HMRC officer wrote to the company, setting out her conclusion that the MAP adjustment was consideration for a supply made by the company to flexible employees for VAT purposes. The decision was confirmed on review and the company appealed to the Tribunal.

The company distinguished its circumstances from those of *AstraZeneca*, which supplied an identifiable item (a voucher) to employees in return for salary sacrifice. Here, there was nothing supplied by the company to the workers. There was also no consideration given by the workers for such a supply, even if it existed. The salary sacrifice was an adjustment to the contracts between the parties; the MAP adjustment was an element in the calculation that resulted, but it was not consideration for anything.

An alternative argument was based on the decision in *Wakefield College*: the arrangement was not made "for the purposes of obtaining income", and was therefore not an economic activity.

HMRC argued that the nature of the supply was the administration of the MAP scheme, which provided a real benefit to the employees in saving them the bother of making claims for expenses through the self-assessment system. HMRC's counsel countered the various points raised by the company based on *Wakefield*. Overall, the MAP scheme was an activity that was pursued on a large scale over a long period and resulted in a significant profit. It was therefore an economic activity.

Judge Ashley Greenbank summarised the arguments in terms of the PVD:

(1) First, it is necessary to show that the operation of MAP involves a supply of services for a consideration for the purposes of art.2(c) PVD. He referred to this issue as the "article 2 question". In the UK legislation, this wording is reflected in s.5(2) VATA.

(2) Second, the supply must be made by a "taxable person acting as such" (also in art.2(c)). A taxable person is a person who carries out an "economic activity" within art.9 PVD. He referred to this issue as the "article 9 question". The equivalent phrase in the UK legislation is "in the course or furtherance of the business" in s.4(1) VATA.

The CA gave its judgement in *Wakefield College* after the end of the hearing, and both parties made submissions based on it. The judge relied heavily on it, because the CA analysed several of the other cases on which the parties had based their arguments – *Finland*, *Gemeente Borsele* and *Longridge on the Thames*.

The first key question was whether there was a supply of goods or services for a consideration for the purposes of art.2. This test requires a legal relationship between the supplier and the recipient, pursuant to which there is reciprocal performance whereby the goods or services are supplied in return for the consideration provided by the recipient. There is no requirement for the consideration to be equivalent to the value of the supply.

The second question is whether or not the supply constitutes an economic activity within art.9. As described by David Richards LJ in *Wakefield College* this is a broad enquiry which has to take into account all of the circumstances in which the goods or services are supplied. The essential test is whether the supply is made for the purpose of obtaining income on a continuing basis.

The judge also referred to *AstraZeneca,* in which employees gave up some of their salary in return for retailer vouchers. The CJEU held that there was a supply of services, and the amount of salary forgone was monetary consideration for that supply. He noted that this was essentially concerned with the "article 2 question" rather than the "article 9 question".

The judge considered that the criteria in the case law for a supply within art.2 were met. He summarised his reasons as follows:

(1) There is a legal relationship between Pertemps and the flexible employee expressed in the contract of employment incorporating relevant terms of the Flexible Employee Handbook.

(2) Pursuant to that legal relationship, the employee exchanges a right to receive a payment of salary for a right to receive a payment of expenses for a consideration. This is clear from the contractual position that I have described above. The two payments (salary and expenses) have different characteristics for tax and national insurance purposes. That exchange potentially involves the supply of a service.

(3) Pursuant to that relationship, the employee provides an identifiable consideration, the MAP adjustment. It is expressed in monetary terms. It does not matter that the employee does not become entitled to the payment (and so no income tax charge arises in relation to that amount). This is clear from the AstraZeneca case. It is sufficient that the employee forgoes part of what could be his or her remuneration as part of a bargain in exchange for the service.

(4) There is reciprocal performance. The consideration is directly referable to the supply: it is only incurred by those employees who make claims under the MAP scheme; and the amount of the charge is proportionate to the number of claims that are made.

The judge did not agree with HMRC's counsel that the supply was "the operation of the scheme". Rather, the employee agreed to forgo an element of salary in exchange for the tax-free payment of expenses. The operation of the scheme was part of the internal administration of the company.

The judge determined the article 9 question in favour of the company for the following reasons:

(1) The operation of MAP does not provide an income stream to Pertemps. It reduces the cost to Pertemps of employing its workers and accordingly increases the profits which Pertemps makes from its business of providing those workers to its clients.

(2) MAP is not a service that could be provided by a third party supplier. The MAP scheme relies upon the issue of the dispensation by HMRC to the employer. It can only be operated by a person who is the employer. It is not "an activity likely to be carried on by a private undertaking on a market, organized within a professional framework generally performed in the interest of generating profit" (Banque Bruxelles Lambert SA v Belgium, per Advocate General Poiares Maduro at [10]).

(3) In a similar vein, this is a supply that is being made pursuant to the employment relationship. The principal supply that is being made in the context of that relationship is the supply by the employees of their labour in consideration for the remuneration and benefits provided by Pertemps. The same was, of course, true in the AstraZeneca case. But this supply is, in my view, too ancillary to the fundamental elements of the employment relationship. This is not a case – as in AstraZeneca – where the employer also makes available to the employee goods or a separate service (the voucher in the AstraZeneca case) which could have been provided by a third person outside the obligations normally performed by the employer as part of the employment relationship.

(4) This is also not a case in which it is necessary to impose a charge to VAT in order to ensure that the coherence of the VAT system is maintained or to ensure that a level playing field is maintained between

participants in a market. This was a factor in the AstraZeneca case. It is not so here.

The judge considered the second ground of appeal more briefly, but concluded that, if he was wrong about there being no economic activity, the supply was exempt within item 1 Group 5 Sch.9 as a "dealing in money". The transaction involved a change in the legal and financial position between the parties as required by the CJEU case law.

Because he had allowed the appeal on other grounds, the judge declined to make any findings in relation to the contentious jurisdictional issue relating to BB 28/11. That could be considered as a question of law by a higher court on appeal without him having made any findings, so he did not need to determine it.

HMRC appealed the decisions on economic activity and exemption to the Upper Tribunal, and the company cross-appealed on the question of whether there was a supply within art.2. The company did not pursue the "collection and management issue" based on BB 28/11. The case came before Mr Justice Nugee and Judge Greg Sinfield.

The company started by arguing that the appeal concerned findings of fact by the FTT and the UT should not interfere. The UT disagreed: the economic activity issue was not "one of those exceptional cases" which is an issue of pure fact. HMRC's challenge was related to the FTT's understanding of the concept of economic activity and its application to the facts in the light of that understanding. The facts were not in dispute. That was a matter which "is particularly well suited to detailed consideration by the Upper Tribunal, with a view to giving guidance for future cases."

The UT cited the leading judgment in *Wakefield College* at length, considering it to provide a useful summary of the principles of the CJEU decisions that preceded it:

- a supply for consideration within art.2 is a necessary but not a sufficient condition for an economic activity;
- that requires a legal relationship between supplier and recipient, pursuant to which there is reciprocal performance whereby goods or services are supplied in return for consideration provided by the recipient;
- there is then no presumption or general rule that such supplies constitute an economic activity within art.9;
- that must be determined by considering, as an objective and wide-ranging enquiry, whether the purpose of the transactions is "the obtaining of income". The word "purpose" might in other contexts suggest an element of subjective intention, but it does not do so here.

The company presented the same argument as it had in the FTT: the provision of the MAP was not something that was "supplied" to the staff, but was simply a part of the remuneration of the employees in accordance with their contracts of employment. HMRC argued that the FTT had come to the correct conclusion, but maintained that the supply should properly be described as the "operation of the scheme", which gave a number of benefits to the staff, in return for the deductions from their pay.

The UT did not agree with HMRC that the characterisation of the supply was in any event irrelevant to the art.2 question. It was an essential part of a transaction within art.2 that there must be "something done"; in each of the precedent cases, there was an identifiable service provided to someone. In this case, the company was simply paying its participating employees in one (tax efficient) way rather than another. Contrary to HMRC's submission, this was not a supply of "enabling the participating employees to obtain the tax deduction up front and hence a cash flow advantage"; rather, it was merely the consequence of the application of an income tax dispensation.

HMRC's counsel appeared to rely on the fact that there was a payment (the deduction of the MAP adjustment) to infer that there was a supply; however, a payment on its own was not enough. It had to be consideration paid in return for something. The UT did not consider that there was any administration service provided, nor was the FTT's characterisation of the supply as "enabling a cash flow benefit" convincing. "*The economic reality is that Pertemps offered its employees two methods of being remunerated in its employment contract, each of which had slightly different tax consequences and, as a result, Pertemps agreed to pay slightly different salaries. We do not regard that arrangement as showing that there is any service supplied by the employer even where an employee chooses the method that provides a greater weekly or monthly take home amount but a lower salary element.*"

Turning to the art.9 issue, the UT did not agree with HMRC's criticisms of the FTT's reasoning or conclusions. The activity of providing something similar to MAP could only exist between an employer and its employees. There was not a general marketplace for such arrangements. The fact that other employers provided similar schemes meant that there might be many individual marketplaces, but that did not engage the principle of fiscal neutrality. The question of economic activity was a mixed issue of fact and law: the FTT applied the correct test and was entitled to make the findings of fact that it did. Its conclusion contained no error of law.

It was then not strictly necessary to consider HMRC's appeal on the exemption issue, but the UT set out its conclusions on that as well, as it had been argued by counsel. The FTT had described the "supply" (that might be exempt) as "an exchange of the employee's right to the payment of part of his or her original salary for a right to receive an expenses payment of a lower amount". That appeared to be potentially within art.135 only if it was a supply by the employee, who was not a taxable person. What the company did was agree to change the terms of its contracts, or to allow the employee to exercise an option to do so. That was not a payment or transfer or "dealing in money". That remained the case even if the effect of the contractual change was to alter the way in which the payment was characterised or calculated. Had it been necessary to do so, the UT would have allowed HMRC's appeal on the exemption issue.

However, the decision on whether there was a chargeable transaction was confirmed, and HMRC's appeal was dismissed.

Upper Tribunal: *HMRC v Pertemps Ltd*

2.12.2 Transfer of lease

GDSL was the freeholder of a property which it had leased on 3 November 2015 for 15 years to a tenant that operated a Starbucks franchise. On 5 April 2016 GDSL sold the property to another company, HSL; by that date, HSL had already contracted to sell the property on to another company, FIL, and completion of both sales took place on 5 April 2016.

GDSL received £800,000 plus VAT for the sale, but did not pass the VAT on to HMRC. HMRC became aware of this and raised an assessment. The company appealed, arguing that the TOGC provisions applied.

Judge Anne Redston considered a "slim bundle" of evidence and precedent case law from *Zita Modes* to *Intelligent Managed Services*. Curiously, the case report refers to the option to tax form evidencing HSL's option, but there is no mention of any option to tax made by GDSL. Without such an option, the supply would surely be exempt; there is also no reference to the issue of a VAT invoice in relation to the supply.

The judge derived the following principles from the precedents:

(1) The transferee's business before the transfer does not have to be the same as the business of the transferor, see Zita at [45].

(2) What is transferred must be capable of operation as a separate economic activity, see Zita at [40] and IMS at [36(1)]. The Property satisfied that test.

(3) The transferee must intend to operate the business which has been transferred; in other words, it must intend to continue the business carried on by the transferor, see Zita at [44] and IMS at [36(4)] and [44]. The nature of the transaction must be such as to allow that continuation, see IMS at [36(5)].

The judge considered that it was clear that GDSL was engaged in a business of letting the property, but HSL was not. It had on-sold the property before it had become its legal owner. She made no finding about the nature of HSL's business in general, as no evidence had been presented to the Tribunal; however, in respect of this transaction, the company had not discharged the burden of proof to show that it was a TOGC.

The appeal was dismissed, also without reference to the old precedent of *Kwik Save Group plc* (VTD 12749), which would support the conclusion that back-to-back sales rule out a TOGC (because the company "in the middle" never actually carries on the business).

First-Tier Tax Tribunal (TC07352): *General Distribution Storage Ltd*

2.12.3 Toolkit

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

HMRC Toolkit: *VAT Output Tax (2019)*

3. LAND AND PROPERTY

3.1 Exemption

Nothing to report.

3.2 Option to tax

Nothing to report.

3.3 Developers and builders

3.3.1 Domestic Reverse Charge postponed

With less than a month to go, HMRC announced the postponement of the introduction of the VAT reverse charge for building and construction services until 1 October 2020. This is in response to industry representations that businesses were not ready, and the risks associated with such a change coinciding with Brexit.

The explanatory Brief notes that the measure was announced in the Autumn Budget 2017 and was subject to technical consultation during 2018, but the long lead time has not been sufficient for everyone to adapt their accounting systems or to take into consideration the negative impact on the cash-flows for many affected businesses, as they will no longer get VAT payments from customers for services where the reverse charge applies.

HMRC say that they remain committed to the introduction of the reverse charge and have already increased compliance resources. They have put in place a robust compliance strategy for tackling fraud in the construction sector using tried and tested compliance tools.

In the intervening year, HMRC will focus additional resources on identifying and tackling existing perpetrators of the fraud. They will also work closely with the sector to raise awareness and provide additional guidance and support to make sure all businesses will be ready for the new implementation date.

HMRC recognise that some businesses will have already changed their invoices to meet the needs of the reverse charge and cannot easily change them back in time. Where genuine errors have occurred, HMRC will take into account the fact that the implementation date has changed.

Some businesses may have opted for monthly VAT returns ahead of the 1 October 2019 implementation date which they can reverse by using the appropriate stagger option on the HMRC website.

R&C Brief 10/2019

The Value Added Tax (Section 55A) (Specified Services and Excepted Supplies) (Change of Commencement Day) Order 2019 was passed on 5 September giving effect to the delay.

SI 2019/1240

The guidance on HMRC's website has been amended to reflect the delay.

www.gov.uk/guidance/vat-domestic-reverse-charge-for-building-and-construction-services

This change was in response to a range of representations, including from the CIOT, which added the recent change to MTD as a further reason to delay.

www.tax.org.uk/media-centre/press-releases/press-release-call-delay-new-vat-reverse-charge

The Federation of Master Builders also asked the government for a delay of at least six months, citing the possibilities of loss of productivity, reduced cashflow and in the worst cases, a hit on jobs, tipping some companies over the edge, particularly small businesses.

In July the FMB published data showing that:

- 69% of construction SMEs has not heard of reverse charge VAT;
- of the 31% that have heard of it, only 33% have prepared for the changes.

The FMB suggested that the low level of planning was a result of HRMC only publishing guidance on the reverse charge VAT four months before the planned implementation, as well as that information being inaccessible to most industry participants.

Meanwhile, Tim Palmer's article in Taxation explaining the new rules will become relevant again in a year's time. The flowchart in the article was incorrectly reproduced from the guidance; the editor issued a correction the following week.

Taxation, 8 August 2019

Also likely to be relevant again in a year are items from the August/September 2019 *Agent update* and the August 2019 Employer Bulletin (which offered a webinars on the interaction of CIS and DRC).

www.gov.uk/government/publications/agent-update-issue-73; www.gov.uk/government/publications/employer-bulletin-august-2019

In an article in *Taxation*, Neil Warren welcomes the delay to the implementation of the rules, and comments on the incorrect belief held by some that reverse charges always cancel out on the VAT return – he gives examples, dealing with both the construction industry charge and supplies purchased from abroad, when the Box 4 figure is smaller than the Box 1 figure.

Taxation, 19 September 2019

3.3.2 Relevant charitable purpose

A charity provided education for children between the ages of 3 and 16 in the Jewish community in Manchester and the north-west of England. It was not registered for VAT. It owned and maintained a school and a nursery. In about 2013, it was decided to move the operations to a newly acquired site. Certain works of adaptation and reconstruction of the existing building were accepted as properly standard rated, but a dispute arose about the liability of the construction of a new structure.

The new build functioned as a multi-purpose hall. It was physically attached to the existing building; following discussions with HMRC, internal access was removed from the plans, so the two parts of the structure had different entrances. Even so, HMRC ruled that the new construction did not qualify for zero-rating.

HMRC's main argument was that the work on both the existing building and the new structure was undertaken pursuant to a single contract for a single scheme of works to convert and alter the existing building for use as a school premises, and that the VAT treatment of the new structure cannot be determined in isolation from the scheme of works as a whole. The new structure was dependent on the heating plant in the main building, and was used for dining by the school pupils on 4 days a week, so was not "capable of independent operation".

The charity argued that the new structure was not an enlargement of or extension to the existing building, but was rather an annexe that was capable of functioning independently and was used for a relevant charitable purpose (Notes 16 and 17 to Group 5 Sch.8).

HMRC's secondary argument was that the building was used in the course or furtherance of a business by the charity, and therefore did not qualify for zero-rating even if it was permissible to look at the annexe in isolation.

The Tribunal heard evidence about the way in which the school operated, and in particular its policies on fees. Its witness stated that "*There are no fees payable for nursery children, only voluntary contributions. If parents cannot afford to pay, they do not pay. Each year approximately 60% of the children will pay full voluntary contributions and the remainder pay a reduced rate depending on affordability and their individual circumstances. The level of contributions payable will be proposed by the parents and agreed by the Head. The witness statement attaches a 14 November 2018 letter from the school, stating that 64% pay full contributions, 18% paid 50-60% contributions, and 18% paid 15-25% contributions*." The school never made a profit and relied on donations to support its costs.

The contractor engaged initially to carry out the work wrote to HMRC to confirm the liability in 2015. It referred to the charging of fees and to the *Yarburgh Children's Trust* case, which at that time had not been overridden by the *Longridge on the Thames* decision in the Court of Appeal.

The Tribunal shortly rejected HMRC's argument that a "single project" had to have a single liability. That was contradicted by their own approach in the recent FTT decision in *Roman Catholic Diocese of Westminster* (TC06692), and there was nothing in the legislation to suggest that part of a larger construction project could not qualify.

The Tribunal was satisfied that the new building was sufficiently separate not to be regarded as an extension, but not so separate that it was a different building. It appeared to be capable of independent operation on the evidence, and it was therefore an annexe that satisfied the conditions of Note 17.

The key question was therefore whether the annexe was used in the course or furtherance of a business. The Tribunal made a number of findings of fact on the balance of probabilities. The school set the level of fees with the intention of covering its costs, then sought donations to provide subsidies for those who could not afford to pay. In November 2018, some 64% were paying the full fee and 36% were paying a reduced fee; none were attending without any payment at all.

The relevant precedents were *Wakefield College* and *Longridge on the Thames*. An economic activity was carried on for the purpose of obtaining income therefrom on a continuing basis. Determining whether there has been a supply for remuneration requires a fact-sensitive enquiry. There is not a checklist of factors to work through. Factors considered to be significant in other cases may provide helpful pointers, but the same factors may assume different relative importance in different cases. This enquiry does not involve subjective factors such as whether the supplier is aiming to make a profit, and concessionary charges are therefore not an indicator against economic activity.

The Tribunal was satisfied that use of the annexe by the school pupils was “de minimis”; it was in effect, at the material time, used only by the nursery. Similarly an office that took up a very small amount of floor space could be disregarded. HMRC’s argument that the whole site had to be considered together was rejected.

The Tribunal took into account the following matters, which could be said to weigh in favour of the conclusion that the supply was made “for remuneration”:

(1) the sole activity of the nursery was the provision of educational services to the children who attended;

(2) those services were supplied for a form of payment or consideration, over a period of time with some degree of frequency and scale;

(3) the nursery was a significant, if minority, part of the total undertaking of the school;

(4) the fees paid were a significant amount of the nursery’s income, and made a significant contribution to the cost of running the nursery;

(5) the level of the normal fee was fixed by reference to the cost of running the nursery, and thereby fixed by reference to the cost of providing the supply to the child in respect of whom the fee was paid;

(6) the benefit of the fee paid accrued to the child on behalf of whom the fee was paid, and the amount of the benefit was proportionate to the amount of the fee paid, at least in the case of a child who paid the full fee;

(7) in the case of a child who benefited from fee remission, the remitted part of the fee was paid out of donations and grants to the school, so that for practical purposes a full fee was still paid in respect of that child, partly by the child’s family and partly through donations; and

(8) there was no reason to suppose that there were not other nurseries that operated on a similar basis, with fees set at a level to cover costs, with the fees of some pupils subsidised through additional donations and grants.

On the other hand, the Tribunal also took into account the following considerations.

(1) It was held in *Yarburgh* and *St Paul's* that, in the circumstances of those particular cases, the running of a nursery or crèche by a charity was not a business activity for the purposes of the law.

(2) More recent case law, including in particular *Wakefield College*, did not cast doubt on the correctness of *Yarburgh* and *St Paul's*. HMRC did not in these proceedings seek to argue that *Yarburgh* and *St Paul's* were incorrectly decided, but sought to distinguish those cases on their facts.

(3) HMRC contended that the percentage of the nursery's finances that was obtained through fees was significantly higher than in the case of *St Paul's*. However, in *St Paul's,* the High Court upheld the decision of the VAT Tribunal, from which it quoted the following passage:

… we think there is an essential similarity between the two cases [*Yarburgh* and *St Paul's*] in that fees were set at a level designed to ensure that the operation broke even. If there are differences between the two cases they seem to us to be differences of scale or degree rather than of principle. … Though it cannot be said that the management of an activity is irrelevant to its character, the essential focus must be on the activity itself. In this, case it is the not-for-profit provision of a day nursery. If that (or something very close to it) is a charitable activity when carried on (as in *Yarburgh*) by a cooperative, does it cease to be charitable, and become a business activity, when it is managed by those who perform it even though in every other respect it is materially identical? In our view the answer to that question is no. The nature of the activity is unchanged. The financial constraints under which it is undertaken are identical. The level of the fees will not go up or down depending upon who is on the committee; their level is dictated by the available income and the cost of supplying the service, factors which would not change in any way if parents dominated the committee, or were its only members.

(4) The nursery in this case was run on a not for profit basis.

(5) The evidence was that a significant number of the children attending the nursery were from disadvantaged backgrounds. This was borne out by the fact that in November 2018, some 36% of the children were paying substantially remitted fees.

(6) Accordingly, a substantial number of the children catered for by this nursery would not be catered for by commercial nurseries, namely those from families who could not afford commercial nurseries.

(7) The Tribunal found that in the present case, the amount of fees charged for children attending the nursery was not of itself sufficient even for the nursery to break even. Had there been no other sources of income, the nursery would in fact have run at a loss. The Tribunal was satisfied that such a loss would have been unsustainable. Thus, if the fees had been the only source of income, the nursery would not have continued to exist at all.

(8) The reality was therefore that while the nursery was funded in part from fees paid by families of children attending the nursery, the ability of the nursery to exist and to carry out its charitable purposes depended on receipt of donations and grants from other sources. The Tribunal found that it could not be said in this case that the supply of nursery services was made for the purposes of obtaining income therefrom on a continuing basis. If anything, the converse was the case, namely that the fees were charged for purposes of enabling the nursery services to be supplied. However, the fees themselves were not sufficient for that purpose.

(9) The Tribunal did not assume that every activity that runs at a loss, or that every nursery run by a charity, was for that reason alone necessarily excluded from the definition of a business under the *Wakefield College* analysis. However, in all the circumstances of this case as a whole, the Tribunal found that the fees charged could not be considered "remuneration" within the meaning of the *Wakefield College* analysis. Nor did the Tribunal consider the donations and grants to be "remuneration" in this sense.

Accordingly, the appeal was allowed: the construction of the annexe was eligible for zero-rating.

First-Tier Tribunal (TC07242): *Yeshivas Lubavitch Manchester*

3.3.3 Updated guidance

HMRC have updated their Notice *VAT on buildings and construction*. The new version includes new information on retention of façades (paragraph 3.2.4) and a revised definition of 'relevant charitable purpose' following FA 2010 (paragraph 14.7.1). Clarification has been added on two withdrawn concessions (paragraphs 3.3.7 – connecting utilities to existing buildings – and 14.6.5 – dining halls in RRP accommodation), and on the meaning of 'personal care' in certain residential accommodation (paragraph 14.6.6).

Notice 708

3.3.4 Washroom conversions

HMRC has updated the Notice *VAT reliefs for disabled and older people* to re-instate guidance clarifying when zero-rating is available for building work to restore space lost in a private residence through adaptations to bathrooms, washrooms or lavatories which are necessary because of a person's disability. Versions of the notice before 18 December 2014 included specific guidance on the point. Taxpayers who relied on that guidance may continue to do so. For works begun after 18 December 2014, the zero rate may be applied retrospectively based on the new, more-detailed, guidance.

(a) Where a bathroom, washroom or lavatory has been installed, extended or adapted in a disabled person's private residence, because of their condition, the work may be zero-rated.

(b) If the works involved have reduced the size of another room within that private residence there will be 'lost space'.

(c) Where, as a result of the works, it becomes necessary to restore the 'lost space', that work can be regarded as part of the work essential to the provision of the bathroom, washroom or lavatory. The restoration of that 'lost space', but only that 'lost space', by restoring the room itself to its original size, can also be zero-rated. This can be done through internal works or by extending outwards or upwards.

(d) The zero rate does not extend beyond the reinstatement of the 'lost space', so everything else, including converting another room in the residence to replace the lost room, will be standard-rated.

(e) If the works go further than the 'lost space' amount, that extra new space must be treated as standard-rated. An apportionment of the zero and standard-rated parts must be made, and further details can be found in VAT guide.

(f) The 'lost space' amount that can be zero-rated must follow the exact specifications in floor measurements, or room volume, of the space lost.

(g) The application of the zero rate in these circumstances only applies to the reinstatement of 'lost space' in terms of building works. It does not extend to fixtures, fittings, units, and so on. However, the zero rate does apply to the provision of utilities that were available in the original converted room.

R&C Brief 7/2019; *Notice 701/7*

3.4 Input tax claims on land

3.4.1 DIY claims

An individual appealed against HMRC's refusal of a DIY claim for £15,764 on the grounds that the claim was made out of time. The appellant had built the house over the period from 2007 to 2016, during which time he had lost his job and had to move into the garage of the building project, both to save on rent and to deter robbery. In 2016 he decided to sell the house because he had found full-time employment in Edinburgh, and commuting from Northern Ireland was unsustainable.

The problem was that the house was still unfinished; the solicitors advised that it could not be sold without a certificate of completion, which seemed inappropriate, but one was nevertheless issued on 26 May 2017. The sale of the house was completed on 1 July 2017, and the DIY claim was submitted on 7 August. The claim was rejected because it was made more than three months after the house was completed.

The reviewing officer suggested that the building had been "complete" when it started being occupied in December 2008, or at the very latest in April 2016, the date of the last invoice included in the claim, later revised to 2 June 2016. ADR failed to satisfy the appellant, so he tried the Tribunal.

He argued that he had complied with all the requirements of the application form; the house was not complete at the time, because substantial works were required to finish fitting it out.

The judge stated that the question for the Tribunal depended on the specific meaning of "completion" for the purposes of SI 1995/2518 reg.201. From the statutory wording, the Tribunal found that the meaning of 'completion' under reg.201(a) was to be given the plain meaning as referential to a certificate of completion because the context required it: the claimant had to obtain and submit a certificate of completion in accordance with reg.201(b)(i). The regulations and guidance notes allowed for "other evidence" only if a completion certificate was not obtained, and that appeared to be an exceptional and alternative situation.

HMRC's view that "completion" was dependent on any other factors was rejected as having no basis in law. The flaws in their approach were analysed in some detail.

The judge noted that the purchaser of the house would not be able to make a further claim for the VAT incurred in completing the work, because the certificate of completion had already been issued. However, the claimant in the case had satisfied the statutory conditions, and his appeal was allowed.

First-Tier Tribunal (TC07240): *Stuart Farquharson*

HMRC refused a DIY claim for £17,707 on the basis that the claim was made out of time. The appellant had occupied the property from 23 December 2015, and had been recognised as chargeable to council tax from that date. He had applied for a completion certificate on 21 January 2016, but it was refused, on the basis that certain tests on protection against hazardous ground gases had not been carried out. In June 2016, new ventilation fans were installed, but the dispute continued until 16 April 2018 when finally the certificate was issued. The refund claim was submitted on 10 July 2018; HMRC asked for further information, then ruled on 24 September 2018 that it was "fair and reasonable to consider that the property was likely complete by the end of 2016. Alternative forms of completion evidence could have been submitted in 2016 to obtain a VAT refund." The individual appealed on the basis that the building was only complete when the certificate said it was, so the claim had been made within time.

Judge Anne Scott noted the above decision in *Farquharson*, and said it was based on radically different facts – a completion certificate issued for a building that was not complete. This was the reverse of that situation. In effect, the refusal of the completion certificate was not because the building was not complete, but because of the need to rectify a defect, or provide evidence that there was no defect. The requirements of the law were absolute, and if a building was complete but no completion certificate was available, then alternative evidence could and should be provided. In this case, the notice of council tax banding would have sufficed.

The appeal was dismissed. The judge expressed some sympathy with the appellant, who had missed out on his claim due to a "lack of awareness". However, the requirements were strict and the Tribunal had no discretion.

First-Tier Tribunal (TC07367): *Stewart Fraser*

Another DIY claimant appealed against the refusal of £7,807 out of a total claimed of £64,659. The reasons for the disallowance were:

- £7,238 because accommodation above a detached garage could not be said to be "designed as a dwelling";

- £569 because three mirrored bathroom cabinets did not qualify as "building materials".

The planning permission allowed the individual to create the accommodation above the garage and to live in it while the project progressed, but once the main house was completed, it was to be used only for purposes incidental to the enjoyment of the main house and for no other purpose. HMRC appear to have regarded this as a "granny annexe" that did not qualify as a dwelling in its own right and which therefore could not be eligible for a DIY claim.

HMRC's counsel referred to various precedents about planning conditions that restricted occupation of annexes (*Burton* and *Shields*). The judge ruled that the situation was quite different: the accommodation above the garage was simply part of the single development. HMRC had accepted that the single development of house and garage qualified as "a dwelling". There was no justification in separating out the cost of creating the accommodation above the garage.

The bathroom cabinets, on the other hand, were "fitted furniture". The fact that they were screwed to the walls and wired into the mains was not enough to make them part of the structure ("fixtures") as opposed to fitted furniture, which was excluded from the definition of building materials.

The appeal was allowed in part.

First-Tier Tribunal (TC07299): *Darren Luke*

3.5 Other land problems

Nothing to report.

4. INTERNATIONAL SUPPLIES

4.1 E-commerce

4.1.1 Guide to MOSS

The online guide to MOSS has been updated to show that the UK VAT MOSS will no longer be available to account for VAT in the EU after Brexit. Businesses making digital sales to consumers in other EU Member States will have to register under the Non-Union MOSS in a Member State, and will no longer benefit from the de minimis turnover threshold of €10,000 per year.

www.gov.uk/guidance/register-and-use-the-vat-mini-one-stop-shop

4.1.2 MOSS exchange rates

HMRC have published the usual table of exchange rates to be used for VAT MOSS quarters ending June 2019.

www.gov.uk/guidance/vat-moss-exchange-rates-for-2019

4.1.3 Rate changes

Belgium, Portugal and Sweden have introduced a reduced rate of 6% on e-publications (from 1 April 2019, 7 June 2019 and 1 July 2019 respectively).

www.gov.uk/guidance/changes-to-the-vat-moss-rate-for-other-countries

4.1.4 MOSS outturn

The European Commission has released statistics for the EU VAT MOSS covering the period from 2015 to 2018. Overall revenues for the Union and non-Union schemes grew from €3bn in 2015 to over €4.5bn in 2018. Registrations in the Union scheme decreased slightly in 2018 owing to the introduction of the €10,000 threshold from 1 January 2019.

The document notes that from 2021 the MOSS will be expanded to cover VAT on distance sales of goods (mainly goods sold online, across borders within the EU and from outside EU) and all other services supplied directly to final consumers in the EU.

ec.europa.eu/taxation_customs/news/european-commission-presents-statistics-vat-mini-one-stop-shop- moss_en

4.2 Where is a supply of services?

Nothing to report.

4.3 International supplies of goods

4.3.1 Brexit continues

In early September, the government launched a public information campaign to prepare the public and business owners for Brexit. The campaign aimed to set out to the public and business owners what they need to do in order to be prepared "when the UK leaves the EU on 31 October 2019". That continues to be in some doubt at the time of writing.

https://tinyurl.com/y2luba5m

At the end of August, the Chancellor of the Exchequer announced plans to issue EORI numbers automatically to a number of traders that had not yet registered with HMRC but were identified as likely to be involved in importing and exporting after Brexit. This "auto-enrolment" was introduced to "help ensure the smooth transit of goods in a no-deal scenario". The aim was to issue 88,000 numbers in two weeks to supplement the 72,000 that had already applied.

www.gov.uk/government/news/chancellor-accelerates-brexit-preparations-for-businesses

HMRC continue to update their collection of guides for traders on changes to customs, excise and VAT procedures in a no-deal Brexit.

www.gov.uk/topic/business-tax/import-export

There is also a HMRC guide for EU businesses not established in the UK on changes to customs, VAT and certain other key regulatory requirements affecting trade with the UK after a no-deal Brexit. The guidance covers a range of related matters, including:

- getting goods through customs;
- import VAT on parcels;
- changes to VAT IT systems;
- providing services;
- transferring personal data;
- selling manufactured goods;
- employing UK nationals;
- sending workers to the UK.

www.gov.uk/guidance/trading-with-the-uk-as-an-eu-business-after-brexit

More statutory instruments providing for a no-deal Brexit were laid on 6 September, shortly before the prorogation of Parliament, but the status of all no-deal legislation is currently as uncertain as everything else relating to Brexit.

www.gov.uk/government/publications/statutory-instruments-relating-to-eu-exit

The Value Added Tax (Miscellaneous Amendments and Transitional Provisions) (EU Exit) Regulations 2019 amend certain references in relation to collective investment schemes and revoke transitional provisions for VAT refunds and fulfilment houses in consequence of the deferral of exit day. They also make transitional provisions for VAT MOSS claims after Brexit.

SI 2019/1214

The Data-gathering Powers (Relevant Data) (Amendment) (EU Exit) Regulations 2019 specify the types of data HMRC can obtain from overseas suppliers in connection with liability for import VAT on goods sent to the UK in postal packets after Brexit.

SI 2019/1221

The Customs and Excise (Miscellaneous Provisions and Amendments) (EU Exit) Regulations 2019 make small changes to customs legislation to prepare the UK for a no-deal Brexit. They are made under the *Taxation (Cross-border Trade) Act 2018* and will come into force on a date to be specified in a separate Treasury order. The changes include: banana weighing and certification; import duty and excise duty guarantees; declarations by non-business travellers; declarations in relation to pleasure craft and private aircraft; rights of appeal and review in relation to matters such as authorised economic operator approvals; and consequential amendments to other customs secondary legislation.

SI 2019/2015

4.3.2 Updated Notices

HMRC have updated their Notice *Customs special procedures for the Union Customs Code*. The list of exclusions from using the authorisation by customs declaration procedure in paragraph 2.19 now includes outward processing goods (unless repair goods). Annex D (paragraph 5.19) has been updated to clarify the conditions for using outward processing relief when exporting and re-importing gold and jewellery.

Notice 3001

HMRC have updated their Notice *Importing goods for test free of duty and VAT* with a revised time limit of 30 days (previously 45 days) to request formal review of an HMRC decision (paragraph 1.4). Text has been removed from paragraph 4.3 to make clear that goods cannot be transferred to another EU country for further testing.

Notice 374

4.4 European rules

4.4.1 Cross-border rulings

The list maintained by the EU VAT forum now contains details of 22 cross-border VAT rulings. The most recent rulings to be added are:

2018/20	Rental car and transport services booked through internet
2018/21	Roadside assistance services
2019/22	VAT treatment of customisation, modification and restoration works on motor vehicles

ec.europa.eu/taxation_customs/business/vat/vat-cross-border-rulings-cbr_en

4.4.2 EU VAT gap

The VAT gap across the EU decreased by €8bn during 2017 to an overall figure of €137.5bn. This represents 11.2% as a percentage of revenue, down from 12.2% in 2016. Actual VAT revenues for the year across the EU rose by 4.1%. Provisional estimates indicate the VAT gap will have continued to fall in 2018.

Romania recorded the highest percentage national VAT Gap with 36% of VAT revenues going missing in 2017. This was followed by Greece (34%) and Lithuania (25%). In absolute terms, the highest VAT Gap of around €33.5 billion was in Italy. The smallest gaps were in Sweden, Luxembourg and Cyprus where only 1% of VAT revenues on average went uncollected.

The VAT Gap decreased in 25 Member States and increased in three (Greece, Latvia and Germany – the last by only 0.2%).

europa.eu/rapid/press-release_IP-19-5511_en.htm

4.4.3 One-Stop Shop

The European Parliament has published its draft report supporting new rules to make online marketplaces responsible for VAT on sales of goods they facilitate, and extending the EU VAT MOSS into a one-stop-shop (OSS) for sales of goods as well as services from 2021. These changes form part of the EU's VAT e-commerce package.

The new rules will treat online marketplaces as the seller in respect of goods with a value up to €150 sold via their platforms by non-EU businesses to customers in the EU, so they will become liable for output tax on the sales. The same rules will apply when non-EU businesses use online platforms to sell goods from fulfilment centres in the EU, irrespective of their value. Online platforms will also be expected to keep records of sales of goods or services made by businesses through them.

The existing EU VAT mini one-stop-shop (VAT MOSS) will be extended into a one-stop-shop (OSS) covering all types of services, as well as intra-community distance sales of goods and distance sales of goods imported from non-EU countries with effect from 1 January 2021.

www.europarl.europa.eu/doceo/document/ECON-PR-639963_EN.pdf

4.4.4 No answer

The Romanian court referred a question to the CJEU to determine the validity of a cross-border refund claim made by a French company and refused by the Romanian authorities. The claim related to purchases made in 2012 for which invoices were only issued in 2015. The referring court acceded to a request by the taxpayer to put questions to the CJEU, attempting to clarify the relationship between the rules that govern the timing of the exercise of the right to deduct and the need for evidence to support that exercise. It appears that the taxpayer wished to establish that the claim was valid as a 2015 claim, because it could not make the claim before it had the invoices; the authorities regarded it as a late claim for 2012, because that is when the transactions took place.

Unfortunately, the order for reference did not satisfy the CJEU's requirements, and the case was ruled inadmissible. Article 94 of the Rules of Procedure of the Court provides:

In addition to the text of the questions referred to the Court for a preliminary ruling, the reference for a preliminary ruling contains:

(a) a summary of the subject-matter of the dispute and the relevant facts as found by the national court or, at the very least, a statement of the facts on which the questions are based;

(b) the content of the national provisions which may be applicable in this case and, where appropriate, the relevant national case-law;

(c) a statement of the reasons which led the national court to question the interpretation or validity of certain provisions of European Union law, as well as the link which it establishes between those provisions and national legislation applicable to the dispute in the main proceedings.

In this case, the subject matter was "very succinctly" referred to, mentioning only the contested decision and the sums at issue. The factual information on which the questions were based was not set out, nor were the national provisions at issue explained. The national court's reasons for uncertainty about the application of PVD articles 167 and 178 were also not specified.

Although the question appears to be one on which an answer would be useful, no answer could be given. The court is at liberty to reformulate its submission.

CJEU (Case C-10/19): *Wilo Salmson France SAS v Agenţia Naţională by Administrare Fiscală* - *Direcţia Generală Regională a Finanţelor Publice Bucureşti and Agenţia Naţională by Administrare Fiscală* - *Direcţia Generală Regională a Finanţelor Publice Bucureşti* - *Administraţia Fiscală pentru Contribuabili Nerezidenţi*

4.5 Foreign refund reclaims

Nothing to report.

5. INPUTS

5.1 Economic activity

5.1.1 Investment management costs

The University of Cambridge has an endowment fund in which it invests donations. It pays professional fees to managers to look after this money, and the income and capital growth on the investments are used to support the various activities of the university, amounting to some 6% of its operational expenditure. As a charity, the university has activities that are business and non-business, and the business activities are taxable (mainly commercial research, sales of publications, consultancy and hire of facilities) and exempt (education).

The university generally claimed input tax in accordance with the 'CVCP guidelines' agreed between HMRC and higher education institutions. These enabled it to avoid preparation of detailed partial exemption calculations. For some years it did not include the investment management costs as residual input tax in the CVCP workings. It made a claim in 2002 which was refused and not pursued, but then claimed again in March 2009 following *Fleming*. The amount claimed was £182,500.

HMRC argued that the investment activity should be regarded as a 'free-standing activity' and therefore 'a supply made not by a taxable person acting as such', in line with the decisions in *NSPCC* and *Wellcome Trust*. Overheads relating to a non-economic activity undertaken for the purpose of an economic activity should not be regarded as recoverable.

The FTT (TC02836) did not agree. In line with the decision in *Kretztechnik*, something that did not involve the taxable person making a supply – whether the issue of shares, or in this case the receipt of dividends – should be related to the activities of the entity as a whole. As the endowment fund financed all the activities of the university, the management fees were residual, and the input tax was partly recoverable.

The FTT decision reviewed each of the major precedents in turn and comments on the reasons for following or not following them. In particular, HMRC's reliance on *BLP Group* was rejected: in that case, the sale of shares was held to constitute an economic activity, whereas the university was not engaged in such activity in relation to its investments.

HMRC appealed to the Upper Tribunal (Mr Justice Simon and Judge Sinfield, 2015). Their counsel's argument was summarised as follows in the decision:

"In order to be regarded as overheads, the costs incurred in acquiring the input transactions must be cost components (in the sense of being incorporated in the price) of all the taxable person's economic activities. Putting it another way, the input transactions must 'burden' the cost of the taxable person's economic activity as a whole. Mr Singh contended that the costs of F&CM's investment management services do not burden the cost of all of the University's economic activities. He submitted that F&CM generates investment income from the Fund and that income subsidises the University's economic activities, thereby reducing the cost to the University of making supplies of education, research, catering, bar sales and conferencing services. He submitted that, in principle, the costs of generating investment income from the Fund do not have a direct and immediate link with and cannot be cost components of the price (or burden the cost) of the University's economic activity as a whole. Mr Singh submitted that the correct analysis was that the costs of the investment management services are cost components of the price of the University's disposals of its investments for consideration and are thus directly and immediately linked with those disposals. He further contended that it is not permissible to 'look through' the disposals of investments for consideration in order to attempt to attribute the costs of the investment management services to the University's economic activity as a whole."

By contrast, the taxpayer's counsel put forward a simple question based on *Kretztechnik*: for what purpose is the outside the scope activity carried out? He submitted that, in the present case, the answer was straightforward: the investment activity is not carried on for its own sake, but for the benefit of all the University's activities.

The Upper Tribunal reviewed *BLP Group*, *Abbey National* and *Kretztechnik* for authority on the treatment of overheads. The principle of *BLP Group* was that an exempt supply to which costs were directly attributable "broke the chain" between overheads and taxable activities of the business as a whole. Here, there was no such chain-breaking event, because the sale of investments was outside the scope investment activity rather than exempt economic activity.

The judges also considered *Securenta* and *AB SKF* for VAT on costs relating to investment activities and the sale of shares. The costs of the investment activity did not "burden the investment activity in the sense that fees were incorporated into the price of investments that were sold". According to *AB SKF*, then, they could be overheads of the business as a whole. HMRC's counsel tried to find a distinction between the raising of capital and the generation of income, but the judges considered that this only arose in the CJEU cases because of their facts, not as a principle of law.

The FTT had found that the investment activity was not carried out for its own sake but for the benefit of the University's economic activity in general. It followed that the costs associated with that investment activity were part of the University's overheads. HMRC's appeal was dismissed.

HMRC appealed again to the Court of Appeal. Patten LJ set out the leading judgment. He reviewed the facts, the law and the precedents. He summarised the issue as the need to choose between two different ways of looking at the attribution of inputs to taxable outputs: one, favoured by HMRC, that required a direct transactional link to a particular taxable output, and ruled out deduction for something that was directly linked to a non-taxable investment "activity"; and the other, which took a more general view of inputs that were associated with the business activity as a whole, and did not regard the investment transactions as an end in themselves.

He discussed the different lines of reasoning as set out in a number of CJEU cases, including *BLP*, *Midland Bank* and *Abbey National*. In the last, the CJEU had not ruled out deduction of VAT incurred in relation to the transfer of a business as a going concern, even though the law regarded it as a "non-supply". That implied, even though it did not spell out, a distinction between something that was directly attributable to making exempt supplies (as in *BLP*) and something that was attributable to activities outside the scope of VAT. The Court's decision in *AB SKF* also supported a distinction between the "magnetism and chain-breaking effect" of exempt outputs on the one hand and non-taxable activities on the other.

The judge accepted HMRC's submission that a finding of a direct link to such a supply will render the input tax irrecoverable just as in the case of an exempt output supply. However, he considered that the appropriate question was whether one can link the expenditure to the ultimate economic activity by treating it as a cost component of a specific taxable supply or as an overhead of the business, i.e. are the costs incorporated in the cost of the taxpayer's economic activities.

Finally, he noted the *Iberdrola* decision, and the fact that the CJEU had overruled the A-G's view that the input tax incurred on a benefit provided to someone else without charge should be irrecoverable. He described the decision as the application of a "but-for test of causation to the works themselves".

The university's counsel sought to rely on the CA judgment in *Associated Newspapers*, which he contended related to a similar question. However, the judge said that in that case it was difficult to treat the purchase of an incentive to buy the newspapers as anything but part of the promotion of the taxpayer's business. In this case he considered that the link in transactional terms was more remote and that the decisions in cases like *Kretztechnik* may have depended on a difference in tax treatment between exempt and non-taxable supplies which later CJEU decisions appear no longer to follow. There was some force in HMRC's comparison with the *Wellcome Trust* case, in which the VAT on the costs of selling a large investment holding was held to be wholly consumed in the selling operation, rather than being capable of attribution to wider economic purposes of the charity concerned.

Overall, the law was not acte clair, and the Court of Appeal decided it was appropriate to make a reference to the CJEU. The questions referred were as follows:

(1) Is any distinction to be made between exempt and non-taxable transactions for the purpose of deciding whether VAT incurred for the purposes of such transactions is deductible?

(2) Where management fees are incurred only in relation to a non-taxable investment activity, is it nonetheless possible to make the necessary link between those costs and the economic activities which are subsidised with the investment income which is produced as a result of the investments, so as to permit VAT deduction by reference to the nature and extent of downstream economic activity which carries an entitlement to deduct VAT? To what extent is it relevant to consider the purpose to which the income generated will be put?

(3) Is any distinction to be drawn between VAT that is incurred for the purposes of providing capitalisation for a business and VAT that produces its own income stream, distinct from any income stream derived from downstream economic activity?

The CJEU gave a relatively brief answer to the question. The judgment notes that it is possible for VAT incurred in relation to a non-business activity to be linked to the activities of a business as a whole (as in *Kretztechnik*); however, the key paragraph states:

"In the present case, it is apparent from the documents before the Court that, first, costs relating to the management of donations and endowments invested in the fund concerned are not incorporated into the price of a particular output transaction. Second, as it is apparent from the documents before the Court that (i) the University of Cambridge is a not-for-profit educational establishment and (ii) the costs at issue are incurred in order to generate resources that are used to finance all of that university's output transactions, thus allowing the price of the goods and services provided by the latter to be reduced, those costs cannot be considered to be components of those prices and, consequently, do not form part of that university's overheads. In any event, as there is no direct and immediate link in the present case either between those costs and a particular output transaction or between those costs and the activities of the University of Cambridge as a whole, the VAT relating to those costs is not deductible."

The answer to the question is very specific to the facts of the case (relating to management of investment funds and use of the money to subsidise operations), but it seems likely that HMRC will see this as a significant victory in showing that a link between costs and taxable outputs has to be more specific than some people have argued since *Sveda* and *Iberdrola*.

CJEU (Case C-316/18): *HMRC v Chancellor, Master and Scholars of the University of Cambridge*

5.1.2 Single Farm Payment Entitlements

After the CJEU decision in the above case, HMRC must have been confident of succeeding in their appeal in the *Frank Smart* case, which proceeded to the Supreme Court shortly after the CJEU issued its judgment. However, the Supreme Court has come to a different decision, distinguishing the facts of the case.

A company ran a farming business in Aberdeenshire. It was allocated an initial entitlement to Single Farm Payments when the scheme started in 2005, then purchased more SFPEs for £7m plus VAT of just over £1m. To be entitled to the payments, the holder had to have "at its disposal" one hectare of land in "Good Agricultural and Environmental Condition" (GAEC) for each unit of entitlement. The company entered into agricultural leases with other farmers to secure this extra land, but under leaseback agreements the other farmers continued to carry on the farming activity on the land.

HMRC regarded the purchase of the SFPEs was a non-business activity on which no input tax could be claimed. The director of the company responded that the purchase (and occasional sale) of SFPE units was an essential part of the financial management of the farm. All the money generated by the payments had been retained in the business and was used for expanding and diversifying it, for example by considering the establishment of a windfarm. None of the SFPs had been withdrawn from the business for personal purposes. The purchase of the units was an overhead of the business similar to the sale of a going concern in *Abbey*

National and the share issue costs in *Kretztechnik*: there was no exempt supply or private use that would interfere with the right of deduction.

In the FTT (TC04179), HMRC's representative pointed out that the payments themselves were outside the scope of VAT (in line with the CJEU decision in *Mohr*). The activity of buying SFPEs was therefore not "predominantly concerned with making taxable supplies". The costs were not components of any outputs. The trader had leased 35,000 hectares of land to support the extra entitlements, but carried on no farming activities on them. The farm itself was only 200 hectares.

The Tribunal agreed with the taxpayer that the purchasing of SFPEs was not a separate activity, but an integral part of the farming business. Given that the purchase was carried out in the context of a fully taxable business, there was no reason to deny the deduction of input tax. It was a fully recoverable overhead cost.

HMRC appealed to the Upper Tribunal, which confirmed the decision below. The judge considered the precedents of *Midland Bank*, *Abbey National*, and *Kretztechnik*, and derived the principle that overheads were sufficiently connected with the taxable outputs of a business to justify recovery – it was not necessary for a cost to relate to particular taxable outputs, as long as it related to outputs in general. It was established that transactions outside the scope of VAT, such as the receipt of SFP payments, were to be ignored in considering input tax recovery – only exempt income led to a restriction.

HMRC considered the purchase of the SFPE units to be "artificial" because it was so out of proportion to the actual farming activities. However, their counsel confirmed to the judge that HMRC regarded any level of SFPE purchases as falling foul of their view that they were linked to activities outside the scope of VAT – it was not just the quantity that created the problem. The judge concluded that HMRC's view was simply wrong. The FTT had come to a justifiable decision of fact on the basis of evidence that the purchases were connected to the taxable business, and that led inevitably to the conclusion that the VAT was deductible as input tax.

HMRC appealed again to the Court of Session. Their argument was slightly refined to the contention that the company was carrying on an extensive separate activity of trading in SFPE units. This was a non-business activity, and the VAT on the purchase of units was incurred in relation to that non-business activity. It was therefore not deductible. Alternatively, input tax could only be deducted on overheads to the extent that they related to the taxable outputs of the business.

The CS set out the relevant provisions of the PVD and the VATA, and recited the same CJEU precedents as the Upper Tribunal, as well as *AB SKF, Sveda* and *Iberdrola*. In respect of the second, the presentations at the hearing were based on the A-G's opinion (which favoured HMRC's case), and the CS asked both sides for further written submissions after the full court judgment differed significantly from that opinion.

The CS summed up the principles derived from the authorities as follows:

First, at a general level, the deduction of input tax is intended to relieve a trading entity entirely of the VAT that is payable in the course of all of its *economic activities; this ensures overall neutrality of taxation in respect of all activities that are subject to VAT.*

Secondly, if VAT paid on an input transaction is to be deductible, there must be a direct and immediate link between that input transaction and the output transactions that give rise to a right of deduction. This is necessary because, if deduction of the input tax is to be permitted, the expenditure on the relevant inputs must be a component in the cost of the output transactions that are charged with the output VAT from which the input VAT is to be deducted.

Thirdly, such a link will be broken if the goods or services obtained through the input transaction are used by the taxpayer for the purposes of an exempt transaction or a transaction that does not fall within the scope of VAT, including activities that are not economic activities in the sense in which that expression is used in dealing with VAT.

Fourthly, the direct and immediate link will not be broken if the goods or services in question form part of the general overheads on the taxpayer's business, in such a way that they form component parts of the price of the taxpayer's product. This represents common sense. When goods or services are supplied to a customer, the costs incurred by the supplier in providing the relevant goods or services will include not only the cost of purchasing or manufacturing the goods or providing the services but also general overheads. To take a simple example, if the supplier manufactures goods, the cost of providing the goods will include not merely the cost of raw materials but also the cost of plant and equipment. This is a general proposition that has been recognized throughout the case law of the Court of Justice.

Fifthly, if the goods or services in question are used partly as general overheads of the taxpayer's business and partly for the purposes of exempt or zero-rated transactions, the input tax must be apportioned between those two uses. The reasons for this are obvious and straightforward.

The judges noted the findings of the FTT that the SFPEs were acquired for the purposes of financing the farming business and possible diversification, and could see no reason to overturn that. Accordingly, the SFPEs were properly considered an input of the business, and the lower Tribunals had reached the correct conclusion.

The judges went on to explain the logical error in HMRC's argument. The receipt of the SFP payments (outside the scope) was merely a consequence of the acquisition of the SFPEs. It should not be considered a separate business activity distinct from the taxpayer's general business. The SFPEs were rather a form of investment, made by the taxpayer for the purposes of its business, and from which income was derived.

The judges found it difficult to understand HMRC's further contention that the intention of the directors as to how the SFPs would be used was irrelevant. The intention of the directors of a company is an objective fact, and it appeared to the CS to be a factor that may properly be taken into account. There was evidence in the documents in this case that established the intention; the statutory expression "used or to be used for the purposes of the business" clearly pointed to the importance of intentions.

The judges also considered it central that the SFPs were paid into the company's bank account, and the directors then had fiduciary duties to apply the funds for the benefit of the company. The primary findings of fact by the FTT contradicted HMRC's argument, which therefore had to be rejected.

The judges commented on a further HMRC argument that SI 1993/1507 would apply if any of the SFPs was used for a non-business purpose. Counsel for the taxpayer had accepted this proposition, and the judges agreed that it was correct to do so.

The judgment concludes with a discussion of other cases that were cited by the parties, which the judges did not think added significantly to the cases already mentioned. Some were consistent in the principles applied, and some related to significantly different facts (e.g. *Securenta* and *VNLTO*).

The judges also referred to the decision of the Upper Tribunal in *Vehicle Control Services Ltd*, where overhead input tax was disallowed because the company had a significant proportion of outside-the-scope income (relating to parking penalty notices). This would be applicable to the present case if, and only if, the SFPs were not in fact used for the purposes of the taxable business (e.g. by developing a wind farm or in farming).

HMRC's appeal was refused again, and they appealed again to the Supreme Court. The *Cambridge University* decision was released after the hearing of the appeal and while the judgment was being prepared in draft; it was taken into account by the judge, and the decision of the court was unanimously in favour of the taxpayer.

The judgment sets out the interesting comparison between the SFP income of the company and its income from cattle sales:

	2010	2011	2012	2013
Cattle Sales	99,284	48,601	97,530	280,997
Cattle subsidies (incl SFPs)	1,202,908	1,795,589	2,515,057	3,312,597
Costs of Sales	(53,925)	(38,666)	(111,885)	(275,389)
SFP Amortisation	(1,141,159)	(1,766,118)	(1,835,693)	(917,840)
Net Profits	(37,079)	(41,812)	534,910	2,499,085

Lord Hodge summarised the VAT legislation in the EU and UK versions and stated the basic principle at issue as follows:

"*Accordingly, the VAT legislation provides for the taxable person to make "taxable supplies", the cost components of which may give rise to input tax which is deductible from the output tax due on those taxable supplies. The taxable person may also make "exempt supplies", defined in section 31 and Schedule 9, which do not give rise to a right to deduct input tax. Further, the taxable person may engage in activities which are not "economic activities" under article 9 of the PVD and are outside the* *scope of the VAT regime. VAT incurred by the taxable person on supplies which are used as components of such non-economic activities are not deductible.*"

HMRC's challenge was that the proper analysis was that the company acquired the SFPE units in order to generate the SFP income, which was outside the scope of VAT. As the receipt of the SFPs was not an economic activity, the purchase of the SFPEs could not be in the course or furtherance of an economic activity (an argument based mainly on *BLP Group plc*). The expenditure was directly and immediately linked to the separate non-economic activity, and therefore could not be a general overhead of the taxable business. The courts below had all erred in considering the subjective intention of the owner, to use the funds generated by SFPs to fund the rest of the business, to be relevant. If there was any doubt on the matter, HMRC's counsel requested a reference to the CJEU.

The company's case was based on the principle of neutrality of the tax, and the fundamental right of fully taxable traders to be fully relieved from the cost of all the VAT they incur.

The judge examined the CJEU precedents, both to find the answer and to show that the answer was "acte clair" and did not require a reference to the CJEU. He noted HMRC's argument that the principles of *BLP Group* should apply to expenditure incurred in connection with an outside-the-scope activity as well as in connection with making an exempt supply; HMRC contended that, otherwise, it would be necessary to consider the trader's subjective intentions, when VAT was supposed to depend on objective characteristics.

The judge went on to consider *Midland Bank* and *Abbey National* for development of the *BLP* principle. He referred to the opinion of A-G Jacobs in *Abbey National*: "*In his view, what mattered was whether the taxed supply was a cost component of a taxable output, and not whether the most closely-linked transaction was itself taxable. It was inherent in an exempt transaction that it broke the chain between a supply and the taxable person's taxable economic activities. As a result, VAT incurred on supplies used by the taxable person for an exempt transaction could not be deducted from VAT paid on a subsequent output supply by that person. Where no supply of goods or services had taken place in a transaction outside the scope of VAT, the chain between a supply to the taxable person and that person's subsequent taxable economic activity was not broken. One was required to look beyond the immediate transaction to see whether the supply, in respect of which a claim to deduct VAT was made, formed a cost component of some other taxable transaction, including in the form of general overheads*."

The line of precedents continued with *Kretztechnik*, *Investrand*, *Securenta*, and *AB SKF*. The principles of this last case appear to be particularly relevant:

i) The right of deduction is an integral part of the VAT scheme and is necessary to achieve neutrality of taxation of all economic activities;

ii) In principle there needs to be a direct and immediate link between a particular input transaction and a particular output transaction or transactions giving rise to an entitlement to deduct before a taxable *person is entitled to deduct input VAT to determine the extent of that entitlement: the expenditure incurred in acquiring the supplies must be a component of the cost of the output transactions that gave rise to the right to deduct;*

iii) But, absent that link between an input transaction and specific output transactions, the taxable person has a right to deduct where the costs of the services in question are part of his general costs and, as such, components of the price of the goods or services which he supplies, there thus being a direct and immediate link between the costs and the person's economic activity as a whole;

iv) On the other hand, where the taxable person acquires goods or services and uses them for the purposes of transactions that are exempt or do not fall within the scope of VAT, no output tax can be collected or input tax deducted.

The judge also considered *Sveda* and *Iberdrola*, before turning to *Cambridge University*. He identified the key reasoning of the CJEU to be that costs incurred in the context of a non-economic activity did not preclude the right of deduction if they were incorporated into the price of particular taxable output transactions; there was no such link to outputs in *Cambridge University*. The reasoning is hard to follow:

"*But, referring to the documents before the court, it concluded that the costs of management of the funds were not incorporated into the price of a particular output transaction. It also concluded, by reference to those documents, that the costs were incurred to generate resources to finance all of the university's output transactions, thereby allowing the price of its goods and services to be reduced. The costs therefore were not components of the price of goods and services provided by the university and could not form part of its overheads. The VAT therefore was not deductible.*"

The distinction between "incorporating a cost into the price of outputs" and "spending money in order to generate funds in order to reduce the price of all outputs" is not easy to define or describe.

The decision in favour of the taxpayer was based on key findings of fact by the FTT. There was objective evidence that the company was carrying on a taxable business and was contemplating using the funds raised on three principal developments – a windfarm, the construction of further farm buildings, and the acquisition of neighbouring farmland. There was no discernable difference in the CJEU precedents between the raising of funds for a taxable business through the issue of shares (*Kretztechnik*) and the receipt of subsidies over several years (this case). On the facts found, the company did not carry out and did not propose to carry out downstream non-economic activities or exempt transactions. Therefore, no question of apportionment under article 173 of the PVD arose.

The judge noted the practical difficulties that this can create for HMRC, who have to refund VAT immediately on the basis of a stated intention to make future taxable supplies. However, the taxpayer had to produce objective evidence to support the existence of the intention, and had to maintain adequate records to show that the funds raised were used for the purpose stated. This might involve HMRC in more investigations than the CJEU had envisaged when deciding *BLP*, but it was part of the VAT system. The clawback provisions of SI 1993/1507 could be used if inputs were subsequently used for a non-business purpose.

HMRC's appeal was dismissed for the fourth and final time.

Supreme Court: *HMRC v Frank A Smart & Son Ltd*

5.1.3 Another holding company

A company appealed against a decision to deny input tax credit of £613,000 for 12/14 to 12/15 and an assessment for £843,000 for periods 06/12 to 09/14, both based on the grounds that the company did not make taxable supplies for consideration. In April 2019 HMRC amended their statement of case to include an additional argument, that if the company did make supplies for consideration, it was doing so other than in the course of an economic activity.

The company's operations involved the acquisition of licences to explore for and produce oil in sub-Saharan Africa. These activities were undertaken by local subsidiary companies, while the holding company was a UK AIM-listed entity.

No written agreements in relation to the services provided to subsidiaries, or consideration for those services, could be found for periods before 2015. HMRC had visited the holding company in 2008 and in 2014 and had clearly not appreciated that the exploration activities were undertaken by subsidiaries; on a further visit in February 2015, this point was identified and led to the decisions under appeal.

The judge considered various precedents on consideration and on holding companies, including *Wakefield College*, *Cibo*, *Larentia + Minerva* and *MVM*. He also noted and agreed with the conclusion of the judge in the FTT decision in *W Resources plc*: "in the case of a holding company supplying management services to its subsidiaries, a finding that those management services are being supplied for a consideration for the purposes of Article 2 PVD must lead inexorably to the conclusion that the holding company is also carrying on an economic activity for the purposes of Article 9 PVD."

Turning to the facts, he noted that it was necessary to consider the contractual position and the commercial and economic realities in determining whether there was a supply for consideration. HMRC's counsel contended that the absence of written agreements before 2015 led to the conclusion that either there were no agreements for services or, if there were, they were contingent on the subsidiary being able to repay the intercompany debt arising.

However, the judge accepted the evidence of the company's chairman and also the audit partner that the commercial and economic reality was reflected in the company's accounts: amounts were debited to the subsidiaries in respect of services provided, and were treated as repayable on demand. The formalisation of the loan agreements in 2015 did not make a significant difference.

The judge distinguished the situation from that in *Norseman Gold* on the grounds that there was more than a "vague intention to levy an unspecified charge at some undefined time in the future": this company actually did charge its subsidiaries for the services that it provided to them. The judge in *W Resources* had accepted that book entries could constitute consideration, provided that the risk of default was not so great that the obligation to pay was effectively illusory. The judge rejected HMRC's contention that there was not "as a matter of economic reality" any obligation for the subsidiaries to pay; the company's representative argued that HMRC had confused the commercial possibility that a debt might not be repaid due to lack of resource with a legal contingency. The judge agreed that fact that a debt is not discharged does not mean that there has not been consideration for the relevant supply. He concluded that there was, both before and after 2015, a legal obligation on the subsidiaries to pay, and that constituted consideration for the supplies.

The judge went on to consider other arguments raised, although this conclusion was enough to decide the case in favour of the appellant. He agreed with the company that a failure subsequently to pay consideration could not undermine the fact that a supply had been made for consideration – the supply and the actual payment were different things.

HMRC relied on the CJEU case of *Bastova*, which concerned prizes for horses winning races, as analogous to the company's likelihood of being paid or not by successful or unsuccessful exploration subsidiaries. The judge agreed with the taxpayer that the situations were different – the outcome of the race was clearly uncertain, whereas the subsidiary was under an immediate and unconditional obligation to pay, even if it subsequently proved unable to do so.

HMRC's argument that the supply of management services was ancillary to a non-economic activity of holding shares in subsidiaries was examined and rejected. In line with the judge in *W Resources*, it was held that a holding company has to be assumed to satisfy art.9 PVD if it satisfies art.2. That is the conclusion to be drawn from the many CJEU cases on management services, where the court has regularly rejected arguments that input tax should be restricted in some way because the costs could easily be funded by outside-the-scope dividend income.

The appeal was allowed.

First-Tier Tribunal (TC07256): *Tower Resources plc*

5.1.4 No business

A company claimed input tax totalling £19,765 for periods from 05/14 to 05/17. HMRC decided that there was negligible substance to the "business" and assessed to claw back the tax. The decision was confirmed on review and appealed to the Tribunal.

The company was owned by an individual who also owned a farm. The company "produced hay and maintained outbuildings" on the farm. HMRC argued that the operation, such as it was, was not carried on according to sound business principles: no invoices had been issued, no payment had been made and no contracts were in place; the only customer was the owner; and there was insufficient substance to constitute a business activity.

The appellant argued that HMRC could not maintain the VAT registration and, at the same time, rule that it was not carrying on a business. That was contradictory, and HMRC ought first to deregister the company if it wanted to disallow the input tax on this ground. The judge did not agree that this was the necessary construction of the law. The mere acceptance that a trader was validly VAT-registered did not amount to an acceptance by HMRC that the person was, at all times while registered, operating as a business.

It was agreed that the company was engaged in making hay for the farmer and in the sale of outbuildings. The company also argued that it was undertaking preparatory acts for new business activities, and would be able to levy management charges once these business activities were generating revenue. These activities appeared to be unrelated to farming, and both were still at a formative stage.

The judge considered the application of the *Lord Fisher* tests, where it was held that a business:

1. is a serious undertaking earnestly pursued;
2. has a certain measure of substance;
3. is an occupation or function actively pursued with reasonable or recognisable continuity;
4. is conducted in a regular manner and on sound and recognised business principles;
5. is predominantly concerned with the making of taxable supplies for consideration; and
6. the supplies were of a kind that, subject to differences of detail, are commonly made by those who seek to profit from them.

The judge was satisfied that the activity satisfied the first three criteria and the sixth, even if the scale of operations was modest. However, the relationship between the farmer and the company undermined the application of "sound business principles". The only involvement of the company was that it owned the machinery that was used for haymaking (left over from a time when it had more substantial farming operations); the farmer did the work himself without charge, and simply decided how much his livery business would pay for the hay.

As the revenue was less than £500 per year, it did not appear that the company's activities were predominantly concerned with making supplies for a consideration, and certainly not with making a profit.

The sale of outbuildings was a one-off exempt capital transaction, and did not undermine the conclusion that the goods and services on which input tax had been claimed had not been acquired for the purposes of a business being carried on.

The appeal was dismissed.

First-Tier Tax Tribunal (TC07356): *Babylon Farm Ltd*

5.2 Who receives the supply?

Nothing to report.

5.3 Partial exemption

5.3.1 Review of partial exemption

HMRC issued a call for evidence until 26 September 2019 on options for improving the operation of VAT partial exemption and the capital goods scheme (CGS), following recommendations made by the OTS in its 2017 VAT review. Proposals include:

- removing the need to seek HMRC's approval for partial exemption special methods;
- reforming or removing the de minimis limit; and
- revising CGS thresholds, categories and intervals.

www.gov.uk/government/consultations/call-for-evidence-simplification-of-partial-exemption-and-the-capital-goods-scheme

5.3.2 Issue of banknotes

The issue of new banknotes is a zero-rated supply within Item 1 Group 11 Sch.8 VATA 1994. HMRC ruled that "issue" only referred to the first introduction of a note into circulation; a Scottish bank argued that it referred also to the returning of a note into circulation on later occasions after it has been passed back to the original issuer. The distinction made a difference to the bank's partial exemption special method.

HMRC argued that the case turned only on the interpretation of the statute, and did not cross-examine the witness. Judge Anne Scott found this "surprising", and commented that the FTT's role is always to find the facts. As HMRC had not disputed them, they were effectively agreed.

The decision sets out how an issuing bank (one that issues its own notes and "promises to pay the bearer on demand") deals with banknotes. An issuing bank's costs include the manufacture, collection and distribution of banknotes, as well as the processing of previously issued banknotes and the destruction of damaged notes.

Although the wording of an agreement could not be traced, it appeared that Customs had agreed in 1973 that first and subsequent issues of notes into circulation were zero-rated. The policy changed, without any change to the law, in 2016, when Notice 701/49 was amended to restrict zero-rating only to the first issue of a banknote. The new policy was to apply with effect from 1 January 2017.

The bank argued that there was nothing different in putting a used note into circulation from the first issue – the supply was the same. When the note was returned to the issuing bank, the promise on it had been met, and the reintroduction to circulation was therefore a new promise – an "issue". The distinction between newly manufactured notes and used notes was artificial.

Scottish banknotes are issued under the Banknotes (Scotland) Act 1845. The judge described the "lifecycle" of a banknote, and agreed with the appellant that putting any note into circulation constituted a new promise. This had to be supported by backing assets, and the position of an issuing bank was quite different from that of a non-issuing bank.

The judge agreed with the bank that HMRC's policy was wrong. The effect of that decision is not described; it is not clear what consideration would be relevant to any of the issues of notes that the bank makes, so a turnover-based method would not be affected by the distinction. Perhaps the bank operates a transaction count or some other special method that takes into account the costs of the operations that it carries out.

Note that both sides relied on the 2002 *Royal Bank of Scotland* case, in which the Court of Session held that "reciprocity fees" charged to other banks for letting their customers draw money out of RBS ATMs was exempt rather than zero-rated. The judge held that those fees were for a different supply, not for the issue of the banknote – they were for allowing the other bank's customers to use the facilities, rather than relating specifically to "issue of banknotes".

First-Tier Tribunal (TC07234): *Clydesdale Bank plc*

5.3.3 Attribution of legal fees

A company claimed that legal fees incurred in bringing litigation were general overheads and deductible as such; HMRC ruled that they were associated with an exempt transaction and were therefore not deductible. The litigation concerned proceedings to recover loans that the company had made with surplus cash that was not currently needed in the farming business, and which the borrowers failed to repay on time. The company did not initially claim as input tax the VAT charged by its legal advisers, but claimed it later by voluntary disclosure. HMRC ruled that the expenses were not general overheads and were not linked to any taxable outputs; if anything, they were linked to the exempt making of loans.

The Tribunal heard the history of the loans and the High Court dispute that resulted, but was not able to see the details of the settlement, because it was made out of court on confidential terms. The company argued that it had recovered some at least of its capital by incurring the legal costs. It also argued that it did not recover any interest, so there was no consideration for an exempt supply; that the other parties had never intended to abide by the loan agreements, so there was no effective loan agreement; and that the cause of action was wider than simply the recovery of the loans, so that the link was to the business as a whole rather than to a particular exempt supply.

The Tribunal held that the company had not provided enough evidence to support its claims that it had not recovered any interest or that the other parties had never intended to abide by the agreements. The judge set out his view of the connection required between the legal fees and the making of the loans: "*When a lender supplies a loan, the lender will need to administer the loan until the borrower's obligations are finally discharged. The administration of a loan will involve, for instance, checking that repayments have been made on time and in the correct amounts, chasing the lender in the event that repayments are in arrears, and ultimately, bringing legal proceedings in the event that a default is not remedied. All of this administration is a cost component of the supply of the loan itself, and the expected costs thereof are typically factored into the supplier's determination of the interest rate at which the supplier is prepared to make the loan, which is in practice the price for which the loan is supplied.*"

Because the judge considered that the costs were directly linked to the exempt making of loans, it was not necessary to consider whether they could also be linked to the business in general. The appeal was dismissed.

First-Tier Tribunal (TC07254): *Newmafruit Farms Ltd*

5.3.4 Toolkit

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

HMRC Toolkit: *VAT Partial Exemption (2019)*

5.4 Cars

5.4.1 No private use

An individual claimed £20,805 input tax credit in relation to the purchase of three cars. HMRC disallowed it on the grounds that the trader had not shown that the cars were not made available for private use. He appealed, arguing that they were not so made available.

The Tribunal noted the trader's evidence that he had other cars for private use. The three cars used for the business were used by his wife and two children, all of whom worked in the business, but the keys were kept in a coded safe and after he had given the code to someone to allow a business journey he changed the code. He had claimed input tax on a car before in 2007, and this had been agreed at a control visit.

The Tribunal considered the precedent case of *Elm Milk Ltd* from 2006. The judge summarised the principles as follows: "the taxpayer has a very high bar to prove. He must prove both that he did not intend to use the car for private use, and that it was not made available for private use. It is however clear that whether any steps taken by the taxpayer a sufficient to prevent the car from being 'made available' is for the Tribunal to decide."

HMRC relied on the fact that "social use only" insurance had been purchased. The Tribunal accepted the trader's assertion that this had been arranged by his wife when she was terminally ill with brain cancer and had made a number of uncharacteristic mistakes. The judge therefore attached no weight to the insurance position.

On the basis that the trader had had a number of conversations with HMRC over many years, and had taken the steps that he considered necessary, on the basis of those conversations, to prevent the possibility of private use, the judge accepted that there was no intention to use the cars for anything other than a business purpose. HMRC had not produced any evidence to show that they were actually used privately.

Turning to the question of "intention to make available", the judge noted two key distinctions between this case and *Upton*: Mr Upton had no other car available for his use, and he had taken no steps to prevent it being available for private use. This trader had taken several steps, including contracts with his children prohibiting private use, and the locking away of the keys. Although he could still use the cars privately himself, he had imposed the slight physical barrier of locking the keys in a safe, while having his own car more readily available for private use. The CA had clearly envisaged that there were circumstances in which a sole trader could fall within the exception to the general prohibition on input tax recovery; if Parliament had intended the legislation not to apply to sole traders, it could have said so.

The judge concluded that the trader did not intend to use the cars privately, nor to make them available for private use. The appeal was allowed.

First-Tier Tribunal (TC07313): *Barry John Graham*

5.5 Business entertainment

Nothing to report.

5.6 Non-business use of supplies

Nothing to report.

5.7 Bad debt relief

Nothing to report.

5.8 Other input tax problems

5.8.1 Fictitious transactions

A Latvian company declared purchases of goods from another Latvian company between February and December 2012 and claimed input tax on the transactions. On investigation, the authorities discovered that these transactions were part of a chain originating in Lithuania, where there was no explanation for the intermediary steps. The ultimate purchaser transported the goods from the warehouse of the first supplier. The authorities formed the view that the chains were a sham and that the claimant could not fail to be aware of that. The domestic purchases were recharacterised as intra-community acquisitions, leading to a liability for acquisition tax.

The question referred was:

Must PVD art.168 be interpreted as precluding a refusal of the deduction of input VAT where the refusal is based solely on the fact that the taxpayer is knowingly involved in the arrangement of sham transactions, but it is not indicated how the outcome of those specific transactions is detrimental to the Treasury because of failure to pay VAT or an unjustified claim for repayment of VAT, as compared with the situation that would have obtained had the transactions been arranged to reflect the actual circumstances?

The court noted that it was possible for there to be innocent explanations for chains of transactions and direct delivery from the first link to the last. The right to deduct VAT was absolute and could not be limited in the absence of abusive practice or fraud. The authority had not identified any undue tax advantage obtained by the claimant or any of the other parties. The claimant could not, therefore, be refused a deduction.

The referring court had not identified a separate issue: whether the purchase should be characterised as an intra-community acquisition. This should depend on an assessment of the circumstances of the case, in particular considering when the transfer to the claimant of the right to dispose of the goods as owner occurred. If that happened before the intra-community transport, then its acquisition was a cross-border transaction.

The CJEU then made the usual comments about correction of invoices wrongly issued (i.e. charging VAT on an exempt intra-community transaction), and reiterated the theoretical right of a claimant to recover overpaid VAT from the authorities directly, if the normal routes to recovery were impossible or excessively difficult.

CJEU (Case C-273/18): *SIA 'Kuršu zeme' v Valsts ieņēmumu dienests*

5.8.2 Dispute remitted to FTT

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

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

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

The company appealed to the Court of Appeal of Northern Ireland, which remitted the case to a differently constituted FTT for reconsideration. The court questioned whether it was proper for the FTT to come to a conclusion on the basis of a case that had not been argued by either of the parties (referred to as "the third man theory"). It was fundamental to the UK's adversarial system that the parties should present the matters to be determined by the court; the court should not come to a conclusion in favour of HMRC on the basis of an argument that HMRC had not raised.

The first appearance of the case before Judge Christopher McNall involved case management directions requiring analysis of the matters (i) which had already been put in issue and (ii) which had already been decided, whether at first instance or on appeal. The appellant objected to HMRC "having another go" at arguments that had been rejected by the FTT in the first hearing.

After a complex consideration of the way in which appeals "work", the judge dismissed the appellant's applications to strike out part of HMRC's statement of case, and to allow the appeal because HMRC had no reasonable prospect of defending it.

First-Tier Tribunal (TC07200): *Ulster Metal Refiners Ltd*

5.8.3 Labour supplies

A company appealed against refusal of input tax claims totalling £83,800 in relation to supplies of temporary labour during 2012. The Tribunal examined the evidence in detail, including transcripts of interviews with the director, and concluded that he had actual knowledge of the connection to fraud, and certainly had the means of knowledge. He was a wholly unconvincing witness. The appeal was dismissed.

First-Tier Tribunal (TC07201): *Hard Hat Logistics Ltd*

5.8.4 Alternative assessments

The Tribunal heard an appeal against alternative assessments for £20,593 for periods 07/12 to 10/15 raised on alternative bases. The preferred assessment disallowed input tax for a variety of different reasons set out at the beginning of HMRC's statement of case:

a) Business entertainment not deductible;

b) Input tax claimed on pro forma invoices;

c) Input tax claimed on invoices when none was charged;

d) Some input tax claimed twice, once on the invoice and once against the payment made;

e) Input tax claimed against supplies received that were either exempt from VAT, such as insurance, or outside the scope of VAT, such as road fuel licences.

The trader argued that these reasons only applied to 11% of the disputed amount, and therefore appealed to reduce the assessment to £2,265. He claimed that the statement amounted to an acceptance by HMRC that there was no dispute about input tax that had been claimed on the basis of invoices that could not now be produced, because that was not mentioned as one of the grounds for disallowance.

The judge commented that HMRC's statement of case "left much to be desired". However, when considered as a whole and in context, the argument was clear enough. HMRC continued to dispute the whole of the amount, and there were numerous references to the inadequacy of the records.

After considering the matter in some detail, the judge concluded that the decision to refuse to accept alternative evidence could not be faulted. The records which were available were extremely sketchy, incomplete and to a significant extent incredible. The appeal against the preferred assessment was dismissed, while the appeal against the alternative assessment (which only reallocated items between periods) was allowed.

First-Tier Tribunal (TC07214): *Wasteaway Shropshire Ltd*

5.8.5 Missing traders

HMRC denied an input tax claim for just over £1m for periods between 03/15 and 01/16. The VAT related to 20 purchases from one supplier, alleged to be a defaulting trader. The company accepted that there was a VAT loss, and on most of the deals accepted that its transactions were connected with that loss. On five deals it did not accept the connection, and on all of them it disputed that it knew or ought to have known of the connection.

The Tribunal examined the history of the trade and the enquiry. It was satisfied that the counterparty in the five deals was a fraudulent missing trader. It did not accept the statements of the company's witnesses that they were naive or unaware of the risks of MTIC fraud in their industry. The company appeared not to have understood the difference between normal commercial due diligence and the "red flag due diligence" that was required when HMRC had issued Notice 726 and given specific warnings of the risk of MTIC fraud. The Tribunal was satisfied that the company should have known that the challenged deals were connected with MTIC fraud.

On the other hand, it appeared that the director had been "beguiled" by the counterparty into believing that he was of good standing in the industry and his supply chains were of no concern to HMRC. The Tribunal concluded that he did not actually know of the connection to fraud.

The appeal was dismissed.

First-Tier Tribunal (TC07315): *Revive Corporation Ltd*

HMRC denied a company input tax of £115,575 in its monthly VAT accounting period 07/13 and £129,399 in its monthly period 08/13. As a preliminary matter, the judge refused an application by the appellants to submit late evidence; HMRC's objections, on the basis that there had been a number of failures to abide by Tribunal directions and the late production of evidence would be unfair to HMRC, overrode the possible relevance of the evidence itself.

The case is unusual in that the subject matter of the alleged missing trader fraud was the purchase of data leads in relation to claims for the mis-selling of payment protection insurance ("PPI"). In each case, the PPI leads so acquired were on-sold by the appellant to a company located in Gibraltar on a back-to-back basis.

The Tribunal examined the history of the business and the disputed transactions in detail. HMRC alleged both that the directors knew and ought to have known that the deals were connected with fraud. The Tribunal considered that it was highly unlikely that the director had actual knowledge, not least because he appointed accountants and lawyers to represent the company, and they might easily have uncovered a fraud. The question of means of knowledge was more finely balanced. After careful consideration, Judge Tony Beare concluded that the test in *Mobilx* was satisfied: "[if a person] should have known that the only reasonable explanation for the transaction in which he was involved was that it was connected with fraudulent evasion of VAT then he should have known of that fact." The appeal was dismissed.

First-Tier Tribunal (TC07326): *Field Opportunities Ltd*

HMRC denied input tax recovery to a company (M) on the grounds that it knew or should have known that its transactions were connected with fraud. In another missing trader case (*Quality Engine Distribution Ltd* TC06403), the FTT found that that company had not made supplies of scrap silver to M; M then argued that HMRC were barred from arguing a different position in their case, while HMRC counter-claimed that this meant the input tax claims were clearly invalid. The amounts initially in dispute were just over £60,000, relating to two purchases of silver from QEDL in February 2016.

M had already been notified of a similar decision concerning eight transactions, with input tax totalling £250,000. The appeals against the two decisions were consolidated, but at the first hearing the Tribunal was concerned only with the impact of the FTT decision in the *QEDL* case. The company argued that the FTT finding that there had been no supply meant that HMRC's case based on *Kittel* had to be struck out (if there was no supply, there could not be a supply connected to fraud); HMRC applied to change their statement of case to put M to strict proof that it had actually received a supply. The FTT had decided that the transactions recorded as sales by QEDL had resulted from a "hijack" of the trader's registration, and it had not in fact made any such sales.

The judge was not impressed by M's argument, which maintained that it had received a supply (so was entitled to claim input tax) and yet sought to rely on a decision that no supply had been made (so HMRC were barred from arguing that it was connected with fraud). If M continued to claim the input tax, HMRC were entitled to question the validity of that claim. That was not an abuse of process by HMRC.

The judge went on to allow HMRC to amend the statement of case to include the alternative ground that there was no supply. This was in line with the overriding objectives of the Tribunals Rules; it was done in response to arguments raised by the appellant, promptly, and would not have taken the appellant by surprise. The decision in *QEDL* had not been released when HMRC filed the original statement of case. In all the circumstances, the amendment should be allowed.

Applications by M to have HMRC barred from part of the proceedings, and by HMRC to have M's appeal struck out, were both rejected. The case will proceed to a substantive hearing.

First-Tier Tribunal (TC07261): *Microring Ltd*

5.8.6 Pre-incorporation expenses

A company appealed against a decision to disallow £31,000 of input tax claimed in relation to legal expenses incurred on defending a claim made by another company against its owner and director (who had previously worked for that plaintiff). The company argued that the individual incurred the legal costs in successfully defending his right to use intellectual property which was subsequently (and had always been intended to be) exploited by the appellant. Therefore, it was argued that the supplies of legal services were directly connected with the business to be carried on by the appellant, and were eligible to be claimed by the company under SI 1995/2518 reg.111.

The individual was a software programmer. He developed his own software in his spare time, but his former employer considered that it had claims over the intellectual property and the individual had breached confidentiality obligations. It sought damages and an injunction, which would have prevented the individual using his software in a business.

The individual incorporated his company only after the litigation had been successfully concluded; however, that was for practical reasons to do with the transfer of the intellectual property while the legality of his actions was in dispute. The Tribunal accepted that the individual had always intended to operate through a company and had incurred the costs in order to be able to do so.

HMRC argued that there was no evidence that the software was owned by the appellant company but rather by the individual. Secondly, the contract with the lawyers for the provision of legal services had been between that firm and the individual, not with the appellant. Therefore, in HMRC's submission, the legal fees incurred had been for the benefit of the individual and not for the appellant.

The taxpayer's representative submitted that, although reg.111 states that HMRC "may" allow an exceptional claim, a good reason would be required to justify refusal if the conditions were met. He argued that the conditions were met, as the individual had always intended to transfer the business to a company, and cited the Court of Appeal's decision in *Praesto Consulting Ltd* as a supporting precedent.

Judge Guy Brannan agreed with the reasoning of the FTT in *Oaks Pavilion*, where it was held that "It is not remotely sufficient that an individual incurs costs, and then later decides to form a company." However, the facts were quite different here. HMRC's statement of case was confused: it concentrated on the need for supplies to be received by the claimant, ignoring the fact that reg.111 plainly contemplates a claim by a company in relation to costs incurred by the individual who incorporates it. All the conditions were satisfied, apart from in respect of one small invoice that was dated after the date of incorporation and after VAT registration. The appeal was allowed, with the parties left to agree the treatment of that small exception.

First-Tier Tribunal (TC07305): *Koolmove Ltd*

5.8.7 Toolkits

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

HMRC Toolkit: *VAT Input Tax (2019)*

6. ADMINISTRATION AND PENALTIES

6.1 Group registration

6.1.1 Partnership registration

A Scottish partnership applied to form a group registration with it as the representative member. HMRC refused on the grounds that it was not a "body corporate" within VATA 1994 s.43A, and was therefore not eligible to join a VAT group registration. The firm appealed, arguing that a conforming construction should be applied to the UK legislation following the CJEU decision in *Larentia + Minerva*.

The facts of the case were agreed: the firm was not a body corporate under UK law, and it was the sole shareholder in three companies registered in Scotland. The firm and two subsidiaries had been separately registered for VAT; in July 2014 two of the subsidiaries formed a VAT group. In November 2013, the group's tax advisers applied for group registration of the partnership with all three companies. This would avoid the need for VAT on intra-group transactions (claimed by the firm to cost £250,000 per month in irrecoverable VAT).

The firm's representative put forward a lengthy argument in favour of allowing group registration, but principally relying on the decision in *Larentia + Minerva* that there was no reason in EU law for Member States to restrict grouping to bodies corporate, and any restriction on membership should be a proportionate measure to prevent avoidance, evasion and abuse. The principle of equal treatment should be applied to prevent distortion of competition in favour of other businesses in the appellant's sector.

HMRC argued that a conforming construction was not possible. The UK, in line with other Member States that had introduced grouping provisions, was still assessing the impact of the *L+M* decision and making appropriate changes to the law. Until that was completed, the principle of legal certainty required the application of the present legislation. If the FTT allowed the appeal, it would amount to "judicial legislation". The CJEU had acknowledged in *L+M* that the grouping provisions did not have direct effect under EU law.

The judge (Dr Heidi Poon) noted that the FA 2019 amendments to s.43 would allow this firm to form a group registration. The effect of the decision would therefore be restricted to this appellant and the financial consequences of the refused application.

It was clear that the firm suffered a fiscal disadvantage in comparison to its competitors, simply due to the legal form it had adopted to carry out its economic activities. This was contrary to precedents on fiscal neutrality, including *Gregg* (which concerned the application of the welfare exemption to partnerships or companies).

The judge went on to consider the *Marleasing* principle in detail, and concluded that the process of interpreting a domestic provision in conformity with EU law involved the following stages:

(1) The first stage is to discern the objectives and the context of the EU provision in question, namely art 11 of the VAT Directive, to which the domestic measure under s 43 VATA is trying to give effect by Parliament.

(2) The second stage is to identify the 'pith and substance' of the measure enacted by Parliament. The 'cardinal feature' of s.43 VATA 1994 is to be found in the statutory wording itself, applying the ordinary rules of construction.

(3) The third stage involves emendation of the statutory wording by reading up or reading down or partial disapplication. The concern at this stage is that the effect of the proposed emendation is not contra legem: that the conforming interpretation goes with the grain of the legislation.

After considering each of these propositions, and the limited effect of the decision following enactment of FA 2019, the judge allowed the appeal.

First-Tier Tribunal (TC07225): *Baillie Gifford & Co*

6.2 Other registration rules

6.2.1 One business or two?

HMRC issued a decision that a cafe run by a husband, and a restaurant run by his wife, were a single business for VAT purposes. As a result, the husband was liable to be registered between 1 December 2016 and 31 July 2016. This resulted in an assessment and a penalty. The trader appealed.

The husband had run the cafe for some years. His wife came from the Philippines, and when she first came to the UK she did not have good English. However, she was a good cook, and in 2009 opened a restaurant in adjoining premises. To start with the operations did not share common areas. However, the toilets that their customers used were public toilets and the restaurant guests had to leave the premises to use them, so in around 2014 some alterations were made to the premises, paid for by the husband, to allow access to the toilets from both the cafe and the restaurant. As a result of these alterations, the cafe and the restaurant shared a washing up area.

There were separate tills, and separate leases, but both leases were in the husband's name. The restaurant had an alcohol licence that was also in the husband's name. Both businesses ordered most of their food from the same wholesaler. In 2015 the husband had responded to a questionnaire from HMRC, reporting that he was the sole proprietor of the restaurant business and his wife was an employee. He was referred to as the owner of the restaurant in reviews on TripAdvisor. There was a website that suggested the two businesses were a single operation run by the couple together.

The couple both gave witness evidence to the Tribunal, explaining a number of the above factors. Each person reported their own income separately on their self assessment returns. The two operations employed different people, and kept separate pools for tips.

The Tribunal noted the CJEU decision in *Nigl* (Case C-340/15): "The necessary objective assessment of independence is to be carried out by examining 'whether the person concerned performs his activities in his own name, on his own behalf and under his own responsibility, and whether he bears the economic risk associated with the carrying-out of those activities.'" It was agreed that where the parties are husband and wife, due to the help that a husband may give to a wife, or vice versa, HMRC should not expect the relationship between two businesses to be wholly at arm's length or to reflect normal commercial practices.

The Tribunal expressed surprise that HMRC had never met with the wife or asked her for any details. The judge did not consider it possible that HMRC could be in possession of facts sufficient to make a reasonable decision without having done so.

The judge considered that the factors indicating separate businesses were stronger than those suggesting a single one. These included the fact that the food for the restaurant and the cafe was ordered separately, from the same supplier (mainly) with the meat for the restaurant being ordered from a different supplier. The menus were completely separate, and the wife had sole control of the menu in the restaurant. The staff were different (apart from the wife helping in the cafe should there be staff illness or another unexpected event). The opening hours were different. The takings were either rung up on separate tills (on a Sunday) or with separate identifiers on the same till (weekdays). The pools of customers were different, with customers viewing the businesses as separate.

The Tribunal was satisfied that the businesses were separate, and also that HMRC could not have had sufficient information to make a reasonable decision. The appeal was allowed, and the penalty was quashed.

First-Tier Tribunal (TC07343): *Charles John Caton*

6.2.2 No deal registrations

HMRC have updated their Notice *Who should register for VAT* with information on temporary arrangements enabling certain non-UK businesses, who do not currently need to register for VAT in the UK by virtue of cross-border simplification schemes, to submit advanced notification of UK VAT registration from 27 September 2019. These registrations will only go live if the UK leaves the EU without a deal.

The detailed explanation is as follows:

4.7.1 Summary

Non-UK businesses in the EU who are currently not required to VAT register in the UK owing to cross-border simplifications, such as call-off stock arrangements and the zero-rating of intra-community acquisitions of goods and accounting, may need to register for VAT if the UK leaves the EU without a deal.

Businesses who are not currently eligible to VAT register yet, need to be from 1 November, can benefit from temporary arrangements for advanced notification of VAT registration. VAT registrations will go live only if the UK leaves the EU without a deal.

This is to support supply chains for UK businesses who have suppliers in the EU with minimal disruption.

HMRC will continue to refuse applications for VAT in all scenarios outside of this in order to protect the integrity of the VAT regime and guard it against fraud.

4.7.2 How to apply under these circumstances

Applications should be submitted online, following the information set out in paragraph 4.1. You should include the following criteria for a voluntary registration from an advanced date:

- *tick the advanced notification box and insert 1 November 2019 as the date of registration.*
- *when reaching the section on business activity enter using trade class/SIC code 99000 European Community*
- *in the free-text box enter the description of what your business does*
- *ensure there is a positive amount entered in the 'estimated taxable turnover in next 12 months' box (otherwise the application will automatically be refused)*
- *check the box indicating you need an EORI number - this applies even if you already have an EORI number*

Ensuring all the details are accurate and complete will reduce the likelihood of your application being rejected.

4.7.3 What this means for you

You will receive notification of your registration and a VRN. The VRN will go live on 1 November 2019 however if a deal is agreed with the EU your registration shall be amended or cancelled.

Notice 700/1

6.2.3 Article

In an article in *Taxation*, Gary Hughes considers the VAT treatment of academy trusts. He provides an overview of the complications arising from the VAT position of academies and the common issues they experience. Academy trusts are responsible for their own VAT accounting and reporting. Academies that are not VAT registered can submit a claim for input VAT on form VAT126.

Taxation, 22 August 2019

6.2.4 Compulsory deregistration

A company appealed against HMRC's decision to cancel its VAT registration under para.13(2) Sch.1 VATA 1994 and to cancel its authorisation to hold duty suspended goods under the Warehousekeepers and Owners of Warehoused Goods Regulations 1999 (WOWGR).

The company had been registered for VAT and WOWGR since 2004. In 2016, an officer raised some enquiries about its trading activities to which the company gave a very brief reply, simply stating that it had had no new deals since the end of June 2016. This led HMRC to cancel the VAT registration on the basis that there was no intention to make taxable supplies. The company appealed, arguing that this was a disproportionate response.

The Tribunal considered that a decision under para.13(2) involves two different exercises of judgement on the part of HMRC:

- first, HMRC must be satisfied that the registered person has ceased to be registrable – in respect of that, the FTT has full appellate jurisdiction;
- secondly, if so satisfied, HMRC must decide whether or not to cancel the registration, since para.13(2) states that they "may" do so, indicating a discretionary power – in respect of that, the FTT has only a supervisory jurisdiction, and has to consider whether the decision was unreasonable.

The judge examined the evidence and concluded that the company had not discharged the burden of proof that it intended to trade in November 2016. The past history of trading was relevant but was not conclusive. Given that the company had argued for a full appellate jurisdiction on the issue, it was surprising that it had produced so little evidence in relation to its intended trading activities, if they existed. The Tribunal concluded that the company was not registrable at the date of the disputed decision.

In respect of the exercise of discretion, the Tribunal considered that the process of decision, review and appeal had given the company plenty of opportunity to persuade HMRC that it should not be deregistered. It had failed to produce anything convincing, and had not particularised the claim that cancellation of its VAT registration would be "catastrophic" for its business. The appeal was dismissed on the deregistration issue.

The decision to cancel the WOWGR approval followed from this. As the company could not demonstrate an intention to trade, it could not demonstrate a need to hold such an approval. That was the stated reason for cancellation, and it was a reasonable cause in accordance with the regulations and with Excise Notice 196.

Both appeals were dismissed.

First-Tier Tax Tribunal (TC07360): *Euro Beer Distribution Ltd*

6.3 Payments and returns

6.3.1 Capital expenditure goods

A company operated a game in which participants had to solve various tasks and puzzles to escape from a locked room. It claimed input tax on expenditure on the rooms while it was registered under the Flat Rate Scheme. The company had been registered under the FRS from 1 October 2015 to 21 November 2016, when its turnover exceeded the £230,000 upper limit.

HMRC disallowed the input tax on the grounds that the payments were for a service of design and installation of the puzzle rooms. The company's director argued that the company did the greater part of the design itself, and what it was really paying for was the goods. Most of the invoices from the suppliers should be taken as single supplies, because they showed stage payments for "a room", rather than a list of itemised separate supplies. HMRC argued that the goods were ancillary to the service of design and installation.

The judge examined the documents and witness evidence and decided that the main invoices were for “the supply of rooms”; this was the provision of a composite whole which was supplied in situ in the company’s building. It was not an ancillary service such as decoration or building work. The judge was satisfied that this was different from previous cases such as *Sally March* and *Eventful Management*: the supplies were of goods with incidental services, not services with incidental goods. There were also other invoices for various “props” that met the same criteria. These became fixed assets that were not consumed but were rather used in the business, so they qualified for deduction. All the invoices in this category were for amounts over £2,000.

There were some miscellaneous invoices that included labour and joinery. These should be treated as supplies of services, because there was no principal supply (the supply of a room) to which the services could be ancillary. These miscellaneous invoices also did not clearly relate to goods that were used on an ongoing basis in the trade, so they were not “capital expenditure goods”.

The appeal was allowed in part, with the parties being left to agree the detailed outcome based on the different invoices.

First-Tier Tribunal (TC07375): *The Great Escape Game Ltd*

6.4 Repayment claims

6.4.1 Group claims again

Four companies in the same corporate group applied for judicial review of a refusal by HMRC to pay a historic input tax claim. The problems, as with many similar cases, arose from changes in group structure over the years (as well as changes of name adding confusion). The four companies concerned were:

- Phoenix Life Holdings Ltd;
- Phoenix Life Assurance Ltd (“Pearl”);
- Pearl Group Management Services Ltd (“PGMS”);
- Pearl Group Services Ltd (PGSL).

HMRC accepted that the group had underclaimed just under £7m of input tax between 1973 to 1997 (arising from the *Kretztechnik* decision in 2005 that the issue of shares was not an exempt activity but one outside the scope of VAT). Pearl had been the representative member of the group throughout that time; in 2003 PGSL replaced Pearl as the representative member (with the same VAT number). On a sale of part of the group’s insurance business, both those companies left the VAT group with that number (starting 234) in April 2005 and became part of another group (the “860 group”), with PGSL as representative member. A different company, Henderson Administration Ltd, became the representative member of the 234 group. In November 2007, both Pearl and PGSL made a claim for the input tax of the 234 group. On 30 April 2008 the 860 group was dissolved; Pearl joined a group of which PGMS was the representative member. PGMS took over the pursuit of the claim from that point on.

The claim was submitted well in advance of the 31 March 2009 *Fleming* claims deadline, but it was not until 2012 that HMRC objected on the grounds that PGMS was not the correct claimant, and not until 2013 that HMRC notified the group that none of them had a valid claim. HMRC's decision was that the right to repayment belonged to the 234 group through its representative member at the time the claim was made; Pearl had ceased to be a member of that group by the time it was made; and a claim by the representative member of that group (Henderson Administration Ltd) would now be out of time.

Pearl maintained that the terms of the sale of the companies in 2004, the right to any VAT repayments was retained by it, and Henderson Administration Ltd confirmed this. Nevertheless, HMRC maintained that it was not possible to accept that the claim was validly made, or could be treated as made on behalf of Henderson, or could now be made late by Henderson.

The claim was only formally rejected on 24 July 2017, with the reasoning being modified on 25 August 2017. The rejection was upheld on review on 9 November 2017, and it was the review decision that was the subject of judicial review proceedings brought by the four claimants. A statutory appeal (i.e. through the Tribunals) was also made against the correctness of the decision that only Henderson could claim; the judicial review application related only to the fairness of refusing any repayment on the grounds that Henderson should have made the claim. The arguments were that the refusal (a) was conspicuously unfair and/or an abuse of power, (b) failed to take into account a material consideration, namely, that HAL had confirmed that any refund should be paid directly to Pearl, (c) was in breach of EU law, and (d) was in breach of the European Convention on Human Rights.

The judge went through the history of the claim, which involved extensive exchanges of correspondence and provision of information during 2008. Other *Fleming* claims were approved and paid. However, the *Kretztechnik* claim was refused on technical grounds in February 2011, confirmed in June 2011; it was at that point accepted that the claim had been made in time. PGMS filed an appeal with the FTT, and HMRC responded with a statement of case raising for the first time the issue that the wrong company was making the claim. This was discussed with the claimant and its advisors for the first time at a meeting in December 2013.

By the time of the decision in July 2017, HMRC had accepted that there was £7m of underdeducted input tax, but ruled that the wrong company had made the claim on the grounds that Henderson had been the representative member throughout. The July 2017 decision was corrected in August, accepting that Pearl had been the representative member when the tax was underclaimed, but maintaining that Henderson was the proper claimant at the time the claim was made.

In the judicial review proceedings, there were arguments about a failure by HMRC to make available internal documents concerning the decision-making process. HMRC undertook to make full disclosure; this showed that the officer dealing with the claim had accepted in September 2011 that PGSL and PGMS had standing to make the claims; this was reiterated in further correspondence. The issue of standing was raised for the first time by another officer in June 2012, but not apparently responded to by anyone.

The judge insisted on obtaining statements from the three officers who had been involved with the claim between 2007 and 2009, all of whom remained employed by HMRC and none of whom had provided any evidence in the initial submissions. None had a clear recollection of this claim. The officer who raised the issue of entitlement also could not recall the specifics.

However, the judge was satisfied on the basis of the evidence that HMRC would have considered the issue of entitlement before March 2009. It should have been among the first things to be decided; it appeared clear that the officers dealing with the matter during 2008 must have concluded that the claimants had standing.

Nevertheless, HMRC argued that such a decision would have been made "in error" and could not therefore be relied on. The judge disagreed. This was a basic check and was being carried out by an experienced officer who, on HMRC's admission, had all the necessary information before him. It followed that HMRC knew, prior to the end of the limitation period, who was making the claim and on what basis, and had determined that no issue of entitlement would be raised.

The judge then considered the principles of overturning a decision based on judicial review. It was not suggested that HMRC deliberately withheld notice of the objection until the limitation period had passed, which would have constituted an improper motive and an abuse of power; however, they had provided no explanation as to how, why and by whom the determination of standing came to be reversed. This reversal without good reason was "so outrageous in its defiance of logic or of accepted moral standards that no sensible person who had applied his mind to the question to be decided could have arrived at it. Certainly a decision maker who felt bound by the highest public standards could not have done so."

It followed that the decision was irrational and conspicuously unfair. The claimants also had a legitimate expectation that, if HMRC appreciated before the expiry of the limitation period that there was a technical problem with the claim which could readily be cured, they would be notified of that objection in reasonable time or the point would not thereafter be taken, an expectation which was breached by the decision.

It was unnecessary to consider whether the decision also breached the claimants' human rights or other principles of EU law. The decision should be quashed and the claim should be paid. The closing remarks of the judge were scathing:

"Given the Commissioners took ten years to reject the Claim on the basis of a technical objection which could and should have been raised, if it was going to be, within weeks of details being provided by the claimants, and further given their lamentable failure to provide or obtain from HMRC''s officers a proper explanation of the decision making process, despite an undertaking given to the court, I see no scope for remitting the matter to them for yet further consideration. Whether payment of the Claim should be justified by permitting HAL to make its own claim out of time (against an undertaking to pay the proceeds to the claimants) or by some other route is a matter on which I will hear further argument, but may ultimately be for the Commissioners to decide."

High Court: *R (on the application of Phoenix Life Holdings Ltd and other companies) v HMRC*

6.4.2 Refunds and price reductions

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

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

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

Before the FTT (TC06094), the taxpayers' counsel argued that art.90 PVD referred to a "price reduction", not a repayment. Art.73 set the taxable amount on liability to pay consideration, not on consideration actually paid. HMRC responded that consideration is "the amount obtained or to be obtained": the companies had actually received the original payments and were not going to repay them, so that was the taxable consideration. In *Freemans v Customs & Excise* (Case C-86/99), which was about sales commission credited to selling agents, the CJEU held that it was not enough to trigger art.90 that a person is entitled to receive a discount at the time of purchase – the consideration would only be reduced when the person withdraws or uses in another way the amount with which her account has been credited.

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

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

On the basis of the price reduction issue, the appeals were dismissed. The companies appealed to the Upper Tribunal, where it came before Mr Justice Mann and Judge Jonathan Richards. The only matter in dispute was the price reduction issue. The UT decision noted that it was unlikely that any money would be returned to unsecured creditors even if the appeal was successful; the VAT refunds would go to fund the liquidators' expenses.

The taxpayer's counsel argued that the FTT had erred in concluding that *Freemans* and *Elida Gibbs* showed that a legal entitlement to a refund was not enough to constitute a price reduction within art.90. The FTT had also wrongly considered that "economic reality" and "common sense" supported HMRC's case.

HMRC's counsel set out the following understanding of how art.73 and art.90 should operate:

(1) Art.73 and art.90 have to be read together and construed consistently with each other.

(2) Art.73 has two aspects: the first dealing with a situation where a supplier "obtains" consideration and the second dealing with a situation where consideration is to be obtained in the future. When the appellants' customers paid them for the provision of tax planning advice, they placed cash freely at the appellants' disposal (as demonstrated by the fact that the appellants spent that cash). That resulted in the appellants "obtaining" consideration from their customers.

(3) Art.90 sets out an inverse position to that set out in art.73. In order for there to be a price reduction that undoes the effect of an "obtaining" of consideration, there would need to be an actual transfer of that consideration back (resulting in the consideration being freely at the customers' disposal). It is for that reason that a mere contractual obligation to return consideration is insufficient and the FTT was correct to conclude that the CJEU had determined this issue in *Freemans*.

The UT examined precedents on economic reality (*Newey*), arts.73 and 90 (*International Bingo Technology SA*, *Boehringer Ingelheim Pharma GmbH*), and the "subjective value principle" (*Naturally Yours Cosmetics* and *Lex Services plc*), as well as *Freemans* and *Elida Gibbs*. After extensive discussion, the judges concluded that none of the authorities provided a clear answer to the present appeal, or a single line of reasoning which could be followed through. Accordingly, they had to approach the matter by extracting relevant principles from the legislation and the cases in order to arrive at an answer.

The key principle was to consider whether the legal obligation of the appellants to make refunds, having received payment from customers, resulted in a situation in which the "price is reduced" for the purposes of art.90. That would reduce the taxable amount under art.73. It was necessary to take into account commercial and economic reality.

The judges concluded from the evidence that the commercial reality was that there would in all probability be no refund to customers. The purported reduction in price was therefore a mere paper one with no commercial substance. In the judges' view, that meant that no adjustment fell to be made under art.90.

The decision did not accept HMRC's argument that there could never be an adjustment under art.90 unless a refund had already been made; that was overstating the case. However, the facts of the present appeal were clear and there was no uncertainty.

The taxpayers' counsel also argued that the failure of the tax avoidance schemes meant that the payments that the customers had made were no longer "in return for a supply". The judges rejected this as contrary to the contracts and to commercial and economic reality.

The appeal was dismissed.

Upper Tribunal: *Inventive Tax Strategies Ltd (in liquidation) and Others v HMRC*

6.5 Timing issues

Nothing to report.

6.6 Records

6.6.1 Making Tax Digital

HMRC has provided the professional bodies with an update on progress made in implementing MTD. Almost a million businesses have signed up and the number of returns filed now exceeds 900,000. Around 1.2m businesses are within the scope of MTD. Reminder letters are being issued to those businesses who have not yet signed up.

The first mandatory MTD filing deadline for quarterly returns passed on 7 August, with 370,000 businesses (76%) in this first 'stagger' group (April to June 2019 returns) having signed up. In addition, 179,000 businesses in stagger 2 (May to July 2019 returns) and 124,000 in stagger 3 (June to August 2019 returns) had signed up early.

According to the ICAEW tax faculty, around 200,000 businesses with turnover below the VAT threshold have so far signed up voluntarily for MTD. The ICAEW has received reports from members of continuing issues including direct debit payments not being collected, incorrect VAT return obligation periods and overseas businesses being unable to sign up. Other issues reported include the lack of filing reminders and confirmation emails. HMRC have acknowledged that 'a small proportion of customers experienced issues when trying to meet their obligations'.

www.tax.org.uk/policy-technical/technical-news/hmrc-digital-services-update-—-august-2019

Before the first significant deadline on 7 August, HMRC issued reminders encouraging people to sign up. If paying by direct debit, they were advised to register for MTD by Friday 26 July. If not paying by direct debit, they should register at least 3 days before their VAT return is due.

www.gov.uk/government/news/businesses-are-being-urged-to-register-for-making-tax-digital-before-august

HMRC have also updated their *Making tax digital for VAT – step-by-step guide* and *Making tax digital for VAT: step-by-step guide for agents* to emphasise the need to register before the very last minute, in particular to preserve existing direct debit arrangements.

www.gov.uk/guidance/making-tax-digital-for-vat;
www.gov.uk/guidance/making-tax-digital-for-vat-as-an-agent-step-by-step

HMRC updated the guide *Check when businesses must join MTD for VAT* to confirm that they will consider applications for exemption from digital reporting and record-keeping on grounds of age, as well as disability, remoteness of location, or where individuals object to using computers on religious grounds.

www.gov.uk/guidance/check-when-a-business-must-follow-the-rules-for-making-tax-digital-for-vat

In an article in *Taxation*, David McCaigue discusses the future use of spreadsheets under MTD. In his view, they will still have a role, and it is not essential to switch to MTD accounting software. He sets out various alternative approaches.

Taxation, 8 August 2019

6.7 Assessments

6.7.1 Wrong methodology

A franchisee company operated five Subway stores in five different towns, all reporting on a single VAT return. HMRC were concerned that the split between standard rated and zero rated supplies was not what they expected, so they carried out visits to invigilate the sales at each store. This led to an assessment for the periods from 02/12 to 11/15 totalling £78,318; it was later accepted that some of that assessment was time-barred, but a further assessment was issued covering 02/16 and 05/16, leading to a total liability of £91,709.

The company applied for a review, which noted that the assessments for 05/12 and 08/12 were out of time and should be withdrawn; however, the reviewer also concluded that the assessments should be revised upwards, because the assessing officer had used "the net figure as declared on the VAT returns and applied the relevant percentage to that, rather than using the gross sales declared." The review confirmed that the assessment was raised to best judgement.

The company made a timely appeal to the Tribunal, and it was agreed that the appeal could be heard without payment of the disputed tax. Judge Geraint Jones considered the principles that underlie a "best judgement" assessment from *Van Boeckel v Customs & Excise* (1981):

(1) The respondents must be in possession of some material upon which a best judgement assessment can properly be based.

(2) The respondents are not required to undertake the work which the taxpayer would ordinarily undertake so as to arrive at a conclusion about the exact amount of tax due.

(3) The respondents are entitled to exercise their best judgement power by making a value judgement on the material available.

(4) The Tribunal should not treat an assessment as invalid simply because it takes a different view as to how the best judgement could or should have been applied to the material available to the respondents. Before the Tribunal interferes, it needs to be satisfied that the purported best judgement assessment was wholly unreasonable.

(5) The Tribunal is to start by assuming that the respondents have made an honest and genuine attempt to arrive at a fair assessment.

The assessments had been arrived at by carrying out a simple observation of the percentage of transactions that were observed by the invigilators and recording those that were "eat in" or "hot takeaways" and those that were "cold takeaways" and therefore zero-rated. The judge agreed with the appellant that this methodology was too imprecise to produce a reliable result: a single customer might buy several items, some of which were standard rated and some of which were zero rated; with no attempt to take into account the relative value of different sales, the result would be very approximate indeed. The judge expressly stated that there was no suggestion that transactions had been omitted or the tills manipulated, so it would have been relatively easy to check those values against what was recorded in the till.

The judge concluded that the assessments were not raised to best judgement and should therefore be quashed. There was some discussion about a particular concern of HMRC, that "meal deals" were not appropriately dealt with: if a customer could buy a sandwich and a fizzy or hot drink for £3, the tills would record this as £2.99 for the sandwich and only 1p for the standard rated drink. The judge agreed with HMRC that the full price should be apportioned on a just and reasonable basis, but declined to say how much additional VAT might arise. It would be difficult to apportion on the basis of cost where one element was bought from a manufacturer and the other was assembled from ingredients in-house – the cost of labour would have to be considered as part of the sandwich. However, from precedents such as *Pegasus Birds*, the judge was satisfied that an assessment that was not raised to best judgement should not be "corrected" by the Tribunal. The appeal was allowed in full.

First-Tier Tribunal (TC07330): *Homsub Ltd*

6.7.2 Lack of records

A sole trader appealed against assessments totalling £140,000 for periods from 09/09 to 12/13. The trader ran three newsagents' shops, and his records were not satisfactory. He did not keep the appropriate till rolls, and other records did not explain anomalous results such as a negative mark-up on standard rated goods. The Tribunal agreed that it was necessary for HMRC to carry out a business economic exercise. The trader objected that HMRC's assessments suggested that he had concealed £1m of turnover over a four year period, nearly £5,000 a week. Nevertheless, the Tribunal accepted that the assessment had been calculated in a reasonable manner and the trader had failed to discharge the burden of proof to displace it. The appeal was dismissed.

First-Tier Tax Tribunal (TC07359): *Kingsley Douglas*

6.8 Penalties and appeals

6.8.1 Default surcharge

A sole trader appealed against a 15% surcharge of £720 for his 03/18 return period. He argued that his business, a pub, had been exceptionally busy over the bank holiday weekend; he had been unsure whether he paid by direct debit or not, and did not check until after the weekend. Judge Anne Fairpo did not consider that this was a reasonable excuse, nor that the penalty was disproportionate.

First-Tier Tribunal (TC07211): *Richard Williams*

A company appealed against surcharges totalling £13,863 for the periods 10/14, 07/15, 01/16, 04/16 and 01/17. The trader did not appear and was not represented; a very late request for a postponement was refused because of previous failure to cooperate with the Tribunal. It appears that the trader had made errors in failing to claim input tax on imported goods; after making a voluntary disclosure, he did not pay VAT shown on returns for a significant period while the repayment claim was investigated and eventually agreed (with some reductions). He considered that it was unreasonable for HMRC to charge penalties for late payment when they owed the company money.

Judge Anne Scott did not uphold this argument. She noted that the claim contained a number of errors, and only arose because the company had made a mistake. It was not reasonable to withhold current payments from HMRC on the expectation of an unspecified future repayment of tax. The appeal was dismissed.

First-Tier Tribunal (TC07275): *Campers Scotland Ltd*

HMRC have updated their Notice *VAT Default surcharge* with a change of address for requesting a review of a surcharge decision. The new address is:

HMRC, Dept 200 VAT (DS Reviews & Litigation), Newcastle, NE98 1ZZ

Notice 700/50

6.8.2 Penalties

A sole trader appealed against a "deliberate conduct" penalty totalling £11,670. He had made a number of different errors in his bookkeeping (without ever employing professional help), including reporting output tax as input tax and failing to declare output tax that he had charged to customers. He accepted that he had made mistakes, but claimed that this was not deliberate; it was accepted that he had suffered from difficult family circumstances during the period from 2011 to 2015, and he claimed that this was the reason for the mistakes.

Judge Sarah Allatt noted that there is no statutory definition of "deliberate", and no argument was presented on its meaning. She reviewed the FTT decisions in *Auxilium Project Management Ltd* (TC05024) and *Patrick Cannon* (TC06254). She agreed with the previous decisions that a deliberate inaccuracy occurs when a taxpayer knowingly provides HMRC with a document that contains an error with the intention that HMRC should rely upon it as an accurate document. This is a subjective test. The question is not whether a reasonable taxpayer might have made the same error or even whether this taxpayer failed to take all reasonable steps to ensure that the return was accurate. It is a question of the knowledge and intention of the particular taxpayer at the time. This is to be contrasted with a careless inaccuracy, which is a failure to take reasonable care. However, there is also the question of whether the taxpayer deliberately shut his eyes to the true factual position.

The judge considered that some of the errors were so basic that they fell into the "deliberate" category. The trader was voluntarily registered, but as that was presumably done in order to benefit from input tax deduction, there was a responsibility to make some effort to understand the requirements. Charging VAT to customers and not entering it on a VAT return, and claiming output tax as input tax by putting it in the wrong box, fell into this category.

Some other errors were described as "inept", the penalties in respect of them were reduced to "careless". The appeal was allowed in part.

First-Tier Tribunal (TC07228): *David Scott*

An individual appealed against personal liability notices totalling £86,743 issued to a company of which he was a director. The company had not appealed against the penalties and went into voluntary liquidation shortly after they were assessed. The Tribunal accepted that it was able to consider the underlying liability of the company in hearing the director's appeal.

The penalties related to input tax claims made in 2015 that were traced to a defaulting trader. The Tribunal considered the evidence separately in respect of three return periods, applying the tests of "deliberate conduct" from *Auxilium Project Management*. In respect of the first period, the Tribunal was satisfied that the director did not actually know, but should have known, that the transactions were connected with fraud. Nevertheless, his conduct was careless rather than deliberate, in that he had failed to carry out adequate due diligence. HMRC had not discharged the burden of proof, and the appeal was allowed in respect of that period.

The Tribunal considered that the situation was materially different in relation to the two subsequent periods. HMRC had given the company specific warnings, and in spite of this and other suspicious factors, the director carried on trading. The Tribunal concluded that he actually knew that the transactions were connected with fraud, and upheld the personal liability notices for these periods.

The appeal was therefore allowed in part. The judge also noted that HMRC should have regarded the decision to issue the PLN as a separate exercise subject to a separate decision about mitigation and special circumstances, rather than simply as effectively enforcing a guarantee for the company's liability against the director. However, the Tribunal did not consider that this made a difference in this case.

First-Tier Tribunal (TC07325): *Kamraan Hussain*

In an appeal mainly concerned with income tax discovery assessments, an individual argued that he should be entitled to claim back input tax for prior years because HMRC had "reopened" them by raising back tax assessments. Judge Anne Scott rejected this contention and dismissed the appeal against income tax assessments and related penalties, which were confirmed on the "deliberate conduct" scale.

First-Tier Tribunal (TC07321): *Kenneth Seath*

6.8.3 Late appeal

HMRC issued decisions to compulsorily register a company, require security, assess £137,000 in VAT and £86,500 in penalties, and allocate the penalty to an individual under a personal liability notice. These decisions were made between August 2017 and March 2018; the individual gave notice of appeal to the Tribunal on 9 October 2018. HMRC objected to permission for the late appeal to be granted.

The company had acquired the goodwill of a previous company owned by the same individual from the liquidator for £1,000. That company had owed HMRC £3.5m.

The excuse given for the late appeal was that the trader and his representative had "honestly and reasonably believed" that an appeal had been validly made, on the basis that the accountants had sent a letter to HMRC objecting to the registration decision. HMRC argued that this was not a reasonable excuse nor an exceptional circumstance. Any prejudice to the appellant from not allowing the appeal to proceed resulted from the appellant's failure to provide information or to assist in establishing the true liability.

HMRC did not consider that prospects of success in the appeal was a key issue, but noted in any event that, contrary to an assertion in the accountant's letter that no assets had been purchased from the previous company, the liquidator's report clearly stated that goodwill (the trading name, phone number, client base and web page) had been purchased, and noted that the new company was operating from the same premises and (as evidenced by the invoices) in the same industry. It therefore seemed hard to maintain that a registration decision based on the TOGC rules could be displaced.

The judge considered the precedents of *Martland* and *Romasave*, which required her to carry out a balancing exercise. The appeals were considerably late; the individual had not attended the hearing to explain the reasons, and a basic misunderstanding that a letter to HMRC was a valid appeal could not be a reasonable excuse. The judge scrupulously set out the reasons for rejecting the application to make late appeals against each of the decisions.

First-Tier Tribunal (TC07237): *Anderson Security Services Ltd and another*

6.8.4 Leave to appeal

The Upper Tribunal made decisions in relation to the apportionment of exempt and standard rated supplies of dispensing and spectacles. Both parties sought to appeal, but the UT granted leave only in respect of one of HMRC's grounds. Both parties applied to the Court of Session for permission to appeal.

In a complex judgment covering a specialised area, the judge decided that it was appropriate to grant both sides permission on both the grounds that they each sought to take forward. In essence, the judge was satisfied that one of the taxpayer's grounds warranted granting permission, and one of HMRC's grounds had already received permission; in the circumstances, it was appropriate to allow all the grounds to be considered by the court.

The judge noted that there were an increasing number of cases in which applicants asked for leave to appeal, and the rules that dealt with that situation were "ripe for review".

Court of Session: *HMRC and DCM (Optical Holdings) Ltd, applicants*

6.8.5 Reinstatement of appeal

A company operating about 45 Subway franchises appealed against an assessment for £533,000 made in respect of periods from 05/06 to 11/08. The issue concerned the apportionment between standard rated and zero rated sales; it was not directly connected with the argument being considered in the lead case of *Sub One Ltd*, but the company also lodged an appeal to stand behind that company in order to benefit from any favourable decision that might result. However, that company lost its appeal in 2014.

The present appellant allowed its own appeal to be struck out by the Tribunal in September 2015, apparently hoping that it could then negotiate a settlement. However, by 2017 it had become clear that HMRC regarded the strike-out as confirming the assessment. The company therefore made an application for reinstatement.

It is striking that HMRC's initial estimate of the understatement was over £2m, but this was reduced by the time of the assessment to £533,000. The Tribunal reviewed the correspondence between the trader, different representatives and HMRC from 2009 to 2015, revealing a lack of communication on what was actually in dispute.

The Tribunal heard discussion about the relationship between appeals to the Tribunal and applications for review. An appeal cannot be made to the Tribunal if a review has been requested, until the time for HMRC to reach a review conclusion has passed. The taxpayer's representative argued that the confused correspondence showed that HMRC were, in effect, still carrying out the review, because it had never been concluded, and there was an implication that the normal 45 day limit had been extended.

This was not accepted by the Tribunal. There was no evidence that there was a common understanding that the time limit would be extended, so the 45 day limit applied. The company was therefore free to appeal to the Tribunal at some point in May 2010; the appeal was therefore validly made, and validly struck out in 2015.

The Tribunal therefore had to consider whether there were good enough reasons to allow reinstatement of the appeal. The company's representative argued that HMRC's confused responses, and failure to give a clear review response, contributed to the company's failure to appreciate the action that it needed to take – in particular, to distinguish itself from the *Sub One* appeal, which concerned toasted sandwiches (which it had always treated as standard rated).

The judge had some sympathy with the appellant, given the level of prejudice it would suffer and the fact that it appeared to have relied on professional advice that had not led it to carry out the correct procedural actions, but there were not enough good reasons for the long delay in asking for reinstatement. "As the Court of Appeal pointed out in *BPP*, the overriding objective in the Tribunal rules incorporates proportionality, cost and timeliness. That is part of the reason why compliance with Tribunal rules and directions is the correct starting point. There have been very significant delays in this case and, whilst FFL may have been poorly advised, this is not the only reason for those delays. There needs to be good reasons to grant relief from sanctions and, although FFL has explained how it comes to be in the position which it finds itself, our conclusion is that these reasons are not sufficiently good to persuade us that it is in the interests of fairness and justice to depart from the normal starting point and to allow its appeal to be reinstated."

First-Tier Tribunal (TC07280): *Florida Foods Ltd t/a Subway*

A different Subway franchisee appealed against assessments in 2016. The company failed to respond to an "unless order" to provide documents and information in 2017, and the appeal was struck out. The company applied for the appeal to be reinstated in 2018 after receiving a demand for the outstanding tax. The director claimed that his previous advisers had "gone silent" without telling him that they no longer represented him, and he had been unaware that the appeal was not ongoing. A number of other franchisees had been using the same adviser, who could not be traced.

The company made a new appeal which was in essence a repeat of the earlier appeal. The Tribunal considered HMRC's application to have it struck out on the grounds that it was not valid, having been struck out once before. Alternatively, it should be regarded as a late application to reinstate the 2016 appeal, and that should be refused because it was very late without good reasons.

By the time of the hearing, the company had accepted that this was not a new appeal, so it concentrated on the application for reinstatement. Judge Jeanette Zaman applied the reasoning of the Upper Tribunal in *Katib*, essentially holding that the failures of an agent should be held to be the failures of the taxpayer. The balancing exercise required by *Martland* did not show good enough reasons for the extensive delay, and the application to reinstate was refused.

First-Tier Tribunal (TC07373): *Subway London Ltd*

6.8.6 Case management directions

In TC06748, Judge Jonathan Richards issued directions to HMRC on disclosure of the names of officers who had been involved in making the disputed decision that the appellant was liable to be registered, and also disclosure of written communications (including e-mails) between those officers, as well as notes of meetings, that were relevant to the question of when HMRC became aware that the appellant was liable to be registered. HMRC claimed that the directions had been complied with; the appellant said they had not. The matter came before Judge John Brooks.

The crux of the dispute between the parties was whether the disclosure direction required every expression of view on liability by any HMRC Officer to be disclosed (as the company contended) or only those documents which recorded a "settled" view of HMRC as an institution (as argued by HMRC). The judge considered that HMRC had honestly believed that their interpretation was correct, but he directed that further documents should be disclosed. He did not consider an "unless order" to be appropriate; he left it to the parties to agree an extension of time for HMRC to comply and for the company then to serve its own witness statements having considered the material disclosed. He did not consider any of the conduct to have been so unreasonable that a costs order was appropriate.

First-Tier Tribunal (TC07320): *Staysure.co.uk Ltd*

6.8.7 Case management

A company appealed against an assessment for £771,430 of disputed input VAT. The company had had its authorisation as a customs warehousekeeper withdrawn in March 2015, after being assessed to claw back input tax in respect of 01/13 to 04/14 in January 2015.

The assessment was in respect of purchases of fizzy drinks that HMRC considered were connected to MTIC frauds. The company hotly denied that it knew or ought to have known of any such connection, and argued that the withdrawal of its approval involved it in considerable expense and loss of profitability. The company succeeded in an earlier dispute about whether it should be allowed hardship relief in having its appeal heard without paying the disputed tax (TC04976 and UT 2017).

A further dispute arose as to whether the company had complied with various directions (referred to as "*Fairford* directions") and whether parts of HMRC's bundle should be struck out as prejudicial. This was the subject of TC06484, in which Judge John Brooks refused the application to exclude the HMRC material, and directed that the appellant would not be allowed to cross-examine certain of HMRC's witnesses, as its response to the directions had not identified matters that were not accepted. The company appealed to the Upper Tribunal.

The UT considered both arguments and offered some guidance on the proper interpretation and use of the *Fairford* directions. The FTT (and the taxpayer's counsel) appeared to have misunderstood the meaning of "matters that were not accepted". Where the trader did not identify specific points of disagreement with a witness statement, but nevertheless did not concede that the matters contained in it were true, then these were "matters that were not accepted", and cross-examination should be allowed.

The UT confirmed the decision of the FTT in relation to admitting the HMRC witness evidence, and issued new directions to the appellant, clarifying how it should respond to the requirement to identify those parts of the witness evidence that would be subjected to cross-examination.

First-Tier Tribunal (TC04976): *Elbrook Cash & Carry Ltd*

6.9 Other administration issues

6.9.1 HMRC annual report and accounts

HMRC's annual report for 2018/19 shows total revenues increasing by 3.6% to £627.9bn; VAT (£135.6bn) increased by 5.4% on higher receipts from the business services, banking and utilities sectors. The report gives breakdowns by tax and by taxpayer groups, as well as the extra yield from compliance interventions (£34.1bn). This is also analysed into different components. Performance indicators such as length of time taken to deal with post and i-forms, and to answer the telephone, are set out (generally rather worse than targets).

Following the annual report, HMRC published further details of "tax under consideration" from large businesses – an estimate of the potential maximum liability in disputed areas before HMRC have carried out a full investigation. This stood at £29.9bn on 31 March 2019 (up from £27.7bn a year before). The average length of time taken to settle enquiries during 2018/19 was 15 months.

www.gov.uk/government/publications/hmrc-annual-report-and-accounts-2018-to-2019

6.9.2 Alternative Dispute Resolution

HMRC have updated their guide to ADR to reflect a new online form and application process, which no longer involves signing a formal memorandum of understanding. The guide sets out how ADR works and when it can and cannot be used.

www.gov.uk/guidance/tax-disputes-alternative-dispute-resolution-adr

6.9.3 Penalties factsheet

HMRC have updated the factsheet *Penalties for inaccuracies in returns and documents* to clarify that they will not suspend more than one penalty at the same time. A suspended penalty will become payable immediately if a subsequent inaccuracy penalty arises. The factsheet also explains the difference between the different types of behaviour and the range of penalties that may apply to each.

CC/FS7a

6.9.4 Prosecutions

A group of nine fraudsters committed missing trader VAT fraud by selling illicit alcohol, which enabled them to evade £34m in VAT and launder £87m through more than 50 bank accounts in Britain, Cyprus, Hong Kong, Dubai and several other countries. They were all convicted of cheating the public revenue, contrary to common law contrary to section

1(1) of the Criminal Law Act 1977, and six were convicted of conspiracy to commit money laundering, contrary to CLA 1977, s 1(1). They received sentences of up to eight years in prison.

https://courtnewsuk.co.uk/bootleggers-jailed-for-120million-vat-fraud/

A father and son ran a horsebox business in Northamptonshire and failed to declare any sales between 2007 and 2015, after claiming that the business had ceased to trade. The fraud was potentially worth up to £1.5m. They were sentenced to 26 months and 20 months respectively.

www.accountancytoday.co.uk/2019/09/05/father-and-son-sentenced-for-horse-box-fraud/

A trader submitted 95 fake VAT returns between October 2010 and August 2018, claiming in total £913,729. He was sentenced to three years in prison.

www.accountancydaily.co/devon-market-trader-jailed-ps900k-vat-fraud

6.9.5 Attitudes to tax

HMRC have published the findings of a survey of 50 "technology sector businesses" carried out in 2017 to find out their attitudes to tax compliance, among other things. Among their concerns was that tax can become complex very quickly for these businesses, particularly those who have ambitions of expanding abroad and growing rapidly before making a profit. VAT is commonly the first complex tax issue they face, earlier than corporation tax, given the focus on growth of sales over profits in the initial stages of business.

Most contacts with HMRC are handled by accountants or external agents, who have an important communications and guidance role, particularly among new businesses.

www.gov.uk/government/publications/understanding-digital-tech-businesses

6.9.6 Insolvency

HMRC have released a policy paper concerning protection of tax in insolvency cases. Legislation will take effect from 6 April 2020 to move HMRC up the creditor hierarchy for the distribution of assets in the event of insolvency in respect of taxes that are collected and held by businesses on behalf of other taxpayers, such as VAT, PAYE, NIC and student loan deductions.

www.gov.uk/government/publications/changes-to-protect-tax-in-insolvency-cases

The Association of Business Recovery Professionals has reported that leading business groups and insolvency experts have written to the Chancellor to warn him that 'that plans to prioritise repayments to HMRC over repayments to other creditors in insolvencies will have serious consequences for the UK economy'.

www.credit-connect.co.uk/commercial-news/corporate-insolvency/treasury-warned-by-industry-bodies-over-insolvency-cash-grab/

6.9.7 Security

A company appealed against a notice to deposit security of £29,450, issued on 27 September 2017. The notice did not give any reasons for the decision; it was backed up on 19 October 2017 by a further letter informing the trader that making taxable supplies without providing the security would be a criminal offence.

The company asked for the reasons and received a letter dated 3 November 2017 which said only: "Security was required for [the appellant] as a result of concerns that the company would be non-compliant. These concerns arose due to the links between this company and other non-compliant businesses which failed owing VAT. The links are demonstrated by personal as well as nature of trade and premises."

The trader appealed to the FTT on 7 February 2019, out of time. HMRC did not object to this; the judge (Geraint Jones) was satisfied that there were valid reasons for the considerable delay, and granted permission for the appeal to proceed.

The judge noted that this was a supervisory appeal, in which the Tribunal did not substitute its own decision for that of HMRC: the trader had to persuade the Tribunal that the decision had been unreasonable. The judge noted that HMRC's decision-maker did not give evidence, and that would generally prejudice HMRC's case. Although another officer gave evidence for HMRC, she could not speak to what factors the decision-maker had actually taken into account, or whether she had appreciated that the process required her to exercise a discretion based upon identified relevant facts.

The judge examined precedents on the need for reasons to be stated for a public law decision to be considered "reasonable". The fact that the trader had not been told what facts had been taken into account, and had not been given any reasons for the decision, meant that the decision was "unlawful and thus unreasonable". The judge made the following important point:

"In our judgement this is plainly a case where the appellant's right of appeal was of little or no practical value unless reasons for the decision were provided so that the appellant could understand the basis upon which the decision was reached. It is only then that the appellant would be in a position to take advice upon whether there would be merit in that decision being appealed. A right of appeal is of little value unless a person can take an informed decision as to whether the right of appeal should or should not be exercised. It is extremely important that a person should be aware of the facts and reasons relied upon by a public authority which imposes a requirement or decision, not only because common fairness so demands, but also because there will usually be significant cost implications if a person has to seek legal advice in circumstances where, had adequate reasons been set out initially, that person may not have incurred the expense of obtaining what might turn out to be unnecessary legal advice."

It was not necessary for the FTT to consider, or to conclude, whether the decision to require security was justified. The making of the decision was flawed, and it therefore had to be quashed. The appeal was allowed.

First-Tier Tribunal (TC07250): *Pachangas Mexican Restaurant Ltd*