VAT UPDATE
OCTOBER 2020

Covering material from July – September 2020

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VAT Update October 2020

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1. INTRODUCTION

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

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

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

1.1 Appeals pending

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

The HMRC website section which reports the progress of appeals was updated on 7 August 2020.

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.

The dates cited for likely hearings must now be treated with caution because of Coronavirus disruption.

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.
- *Ampleaward Ltd*: HMRC seeking leave to appeal against the UT decision that the company was not caught by the "fallback acquisitions" rule.
- *Anna Cook*: HMRC granted leave to appeal against the FTT decision that classes in Ceroc dancing qualified for exemption as "educational" (hearing scheduled for October 2020).
- *Beigebell Ltd*: HMRC succeeded in appeal (covered in July 2020 update) against the FTT decision that a company's directors did not have the means of knowledge of the connection of their company's transactions to a missing trader fraud: case remitted to a differently constituted FTT.

- *Good Law Project*: (not on HMRC's list) HMRC appealing against decision of High Court that it was lawful for them to disclose certain facts in relation to a dispute with a taxpayer, so it was not necessary for them to apply for a court order in order to be granted permission to do so (hearing scheduled for Court of Appeal in April).
- *News Corp UK and Ireland Ltd*: HMRC have been granted leave to appeal against the UT's decision that digital newspapers qualified for zero-rating (hearing listed for 1 December 2020).
- *NHS Lothian Health Board v HMRC*: Court of Session allowed taxpayer's appeal on grounds that "no repayment" had to be the wrong answer; remitted to FTT for reconsideration of the amount; HMRC seeking leave to appeal to the Supreme Court.
- *Pacific Computers Ltd*: MTIC case remitted by the UT to differently constituted FTT for rehearing (not on HMRC's list).
- *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).
- *Royal Opera House Covent Garden Foundation*: HMRC succeeded before the UT in their appeal against the FTT decision on the partial exemption recovery percentage; taxpayer has applied for leave to appeal to the CA.
- *Target Group Ltd*: company has been granted leave to appeal against UT decision that its supplies of loan administration services did not fall within art.135(1)(d) – CA hearing scheduled for May 2021 (not on HMRC's list).
- *The Core (Swindon) Ltd*: HMRC have been granted leave to appeal against the FTT decision that certain products were "liquid meal replacements" rather than "beverages" (scheduled for October 2020).
- *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 (Case C-459/19): the A-G's opinion (favouring HMRC) was covered in the July update.
- *Thorsteinn Gardarsson t/a Action Day A Islandi*: HMRC have succeeded in their appeal against the FTT decision that a trader's products qualified as "books" rather than "stationery", and some issues have been remitted to a differently constituted FTT for further consideration.
- *Tower Resources plc*: HMRC have been granted leave to appeal to the UT on three grounds against the FTT's decision that a holding company was entitled to recovery of input tax on some overhead costs (hearing scheduled for April 2021).

1.2 Decisions in this update

- *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 – A-G's opinion was in the July update, and the slightly different full court judgment is in this update.

- *Cheshire Centre for Independent Living*: the taxpayer withdrew from the appeal, but nevertheless has been awarded costs because HMRC conducted the appeal unreasonably.
- *DCM (Optical) Ltd*: the Court of Session upheld HMRC's appeal and dismissed the company's appeal against various decisions in relation to assessments for underdeclared output tax on mixed supplies of spectacles and dispensing services.
- *Newey (t/a Ocean Finance)*: HMRC describes the CA decision as a "partial win for HMRC". The case was remitted to the FTT for further consideration in the light of the CJEU judgment, and the FTT has confirmed its 2010 decision – a complete win for the taxpayer.
- *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 – hearing scheduled for June/July 2020).
- *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 (hearing June 2020).

1.3 Other points on appeals

- *Snow Factor Ltd*: the Upper Tribunal allowed the company's appeal on the application of the reduced rate to its lift passes (April 2020 update); HMRC are not appealing further.

2. OUTPUTS

2.1 Scope of VAT: linking supplies to consideration

2.1.1 Cancellation charges

Vodafone in Portugal concluded contracts with customers which included promotional terms that tied in the customers for a set minimum period. The contracts specified that, if the customers failed to continue to buy services throughout the tie-in period, they would still have to pay the contracted amount.

A Portuguese consumer protection law required such tie-in charges to be restricted to an amount that fairly represented the benefits granted to the customers under the contracts for which the supplier had not yet been compensated. There were requirements for disclosure of the calculation of contracted amounts, and the cancellation charge could not exceed the costs incurred by the supplier in installing the service. This amendment came into force in 2016, and Vodafone complied with it from August 2016 onwards.

For the period to November 2016, the company self-assessed output tax on the cancellation charges, but then reclaimed the output tax on the basis that the charges did not represent consideration for a supply.

The Portuguese court considered that the circumstances were different from the precedent case of *MEO – Serviços de Comunicações e Multimédia* (Case C-295/17), where the charges were levied for the outstanding part of the minimum contracted period and were held to be subject to VAT. In *MEO*, the court appeared to have come to its decision on the basis that the contracted consideration was payable one way or the other, regardless of the enjoyment of the services; in the present case, the compensation to Vodafone was calculated to compensate the company for what the referring court considered to be genuine commercial and economic damage suffered by early termination of the contract.

The questions referred suggested the possible reasons for regarding the payment as not being for the supply of services: it was not related to the outstanding instalments; it was payable after the relationship had been terminated and no further services or consumption would follow; the calculation was set out in the contract as required by law; and it was intended not to exceed the costs incurred by the supplier in providing the service.

The court started by reciting the condition for a transaction to fall within art.2 PVD: there must be a direct link between the service supplied and the consideration received. In *MEO*, it was held that the consideration for the price paid at the time of the signing of a contract for the supply of a service is formed by the right derived by the customer to benefit from the fulfilment of the obligations arising from that contract, irrespective of whether the customer uses that right. The supplier had made the service available, and that was itself the supply of the service; whether the customer used it was immaterial.

The court considered that the effect of the “compensation” provisions in the contract was to guarantee the supplier a minimum contractual remuneration for the service provided or made available. In economic

reality, which was a fundamental criterion for the application of the VAT system, that was effectively the same situation as in the *MEO* case.

Cases in which a payment has been held not to be consideration were distinguished: this was not “voluntary and uncertain” as in *Tolsma*, nor “difficult to quantify and uncertain” as in *Bastova*. It was not a statutory payment as in *Apple and Pear Developments*, nor purely compensatory as in *Societe Thermale d’Eugenie-les-Bains*. Rather, the payment was made in the context of a legal relationship characterised by reciprocal performance between the services provider and its customer and that, in that framework, the payment constituted a contractual obligation for the customer.

The court rejected the argument that the payment was compensatory in nature. In the context of an economic approach, the payment was linked to the costs of providing the service, which would also be linked to the price the operator would set for providing the service.

The court answered that amounts received by an operator in the event of an early termination, for reasons specific to the customer, of a services contract requiring compliance with a tie-in period in exchange for granting that customer advantageous commercial conditions, must be considered the remuneration for a supply of services for consideration within the meaning of art.2 PVD.

CJEU (C-43/19): *Vodafone Portugal – Comunicações Pessoais SA v Autoridade Tributária e Aduaneira*

2.1.2 HMRC policy on cancellation charges

HMRC have announced a significant change in their position on VAT and compensation payments. Following the *MEO* case and the *Vodafone* case above, they will now treat more payments that are described as “compensation” as being consideration for supplies within the scope of VAT.

Payments arising out of early contract termination are clearly within the cases listed, and will be treated as consideration for the contracted supply. Liquidated damages specified in a contract, which HMRC previously regarded as outside the scope, will be treated in the same way. Payments for breach of contract may also be regarded as falling within the scope of the contract and therefore will be taxable; this is the most arguable point, where HMRC’s internal guidance appears to recognise that the payment has to be “envisaged under a contract” to constitute consideration, rather than being purely for the breach.

The R&C Brief is very brief indeed, referring only to the more detailed paragraphs in the internal manuals. However, it does contain the statement “Any taxable person that has failed to account for VAT to HMRC on such fees should correct the error.” This implies that HMRC regard this as a situation where the clarification in the case law justifies retrospective taxation; normally, where HMRC have such an explicit “favourable” statement in their policy, tax charges are only considered to be due from the date that the statement is changed or withdrawn. However, it seems that HMRC have decided to think again, and have instructed officers not to apply the new policy for the time being.

Revenue & Customs Brief 12/2020; VATSC05910, VATSC05920 and VATSC05930

2.1.3 Article

In an article in *Taxation*, Elizabeth Small discusses the implications of this change of policy for real estate transactions. Deposits for such transactions do not normally create a tax point until completion, if the deposit is held by a stakeholder rather than being received by or on behalf of the vendor; however, because the deposit will be forfeited if the purchaser fails to complete, there is now an argument that VAT ought to be paid on the deposit.

Taxation, 10 September 2020

2.2 Disbursements

Nothing to report.

2.3 Exemptions

2.3.1 Reverse charge decision confirmed

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

It was accepted that the US company made a single supply of the platform (called "Aladdin"), and separate supplies of some other services. There were two questions: did the SIF exemption apply at all, when the supply was from one company to another rather than to the individual small investors? And if it did apply, could the reverse charge be apportioned because Aladdin was also used for non-SIF investments? The dispute had been running since a ruling request in 2012, and the FTT hearing (TC06069) covered appeals for the periods from 1 January 2010 to 30 September 2016.

First-Tier Tribunal

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

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

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

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

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

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

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

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

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

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

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

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

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

The key test, therefore, was whether the services supplied by the US affiliate to the UK companies formed a distinct whole, and were specific to, and essential for, the management of special investment funds. The judge was satisfied that they were "specific and essential": the meaning that HMRC tried to import into that expression was too restrictive. As regards "a distinct whole", the judge noted that the CJEU had not clarified

the meaning of this expression, and the A-G opinions in the two cases seemed to be inconsistent. Nevertheless, he was satisfied that the services were "interrelated and had an inner coherence", which he considered to be the test. HMRC had argued that they were "a mere tool used in management of SIFs", but the judge did not agree that this was the relevant test.

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

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

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

Upper Tribunal

The company appealed to the Upper Tribunal (Mrs Justice Falk and Judge Roger Berner) on the apportionment issue. HMRC cross-appealed on the exemption issue, so the whole argument was revisited. Although it was primarily the taxpayer's appeal, the exemption issue was considered first, because the apportionment issue only arose if exemption was available in principle.

The UT considered *Sparekassernes Datacenter* (Case C-2/95) in detail before reviewing the cases on which the FTT decision was based. The principle established was that "in order to be characterised as exempt transactions within the exemptions in question, the services provided must, viewed broadly, form a distinct whole, fulfilling in effect the specific, essential functions of a service as described by the relevant provisions."

Turning to the decisions in *Abbey National* and *GfBk*, the UT carried out its own analysis of the judgments, and concluded that the requirements for exemption of management of SIFs depended on "distinctiveness" and "specificity". These tests were considered in the A-G's opinion in *GfBk*, which was expressly approved by the full court in that case. The UT rejected HMRC's arguments that there was any error of law in the FTT's conclusions in this area. The judges did not agree with HMRC that "significant aspects of management and administration have to be outsourced and that each of those aspects needed to be sufficiently outsourced". The Aladdin Services formed a distinct whole, and the FTT's conclusion was the only one that could properly have been reached on the evidence before it. There was no basis for a reference to the CJEU, as HMRC requested.

The taxpayer's counsel based his argument on the apportionment issue partly on the CJEU judgment in *Commission v Luxembourg* (Case C-274/15). Although this concerned the cost-sharing exemption, it did

contain a suggestion by the court that a single supply could be apportioned between exempt elements (the underlying cost that was used for the group member's exempt or non-taxable activities) and taxable elements (the underlying cost that was used for the group member's taxable activities). This gave the judges "pause for thought".

After some further consideration of other judgments on compound and multiple supplies, the judges concluded that they could not with certainty decide the apportionment issue. As a result, reference should be made to the CJEU, and in the meantime, the appeal would be stayed.

Advocate-General's opinion

Advocate-General Pikamae gave his opinion at the end of March 2020. He started by summarising the facts found by the UK Tribunals and the essential issue, which was the apparent recognition of the possibility of exempting part of a supply in the *Luxembourg* case. If the supply could be apportioned, the further question was whether the values of the funds under management would be an appropriate basis for that apportionment.

Next, the A-G reviewed the precedent cases on 'what are SIFs' (member states have some discretion, but must exercise it in a manner consistent with EU law – *JP Morgan Claverhouse*) and 'what is management' (member states have no discretion, as it is an independent concept of EU law – *Abbey National*).

The A-G considered that the development of artificial intelligence probably warranted an examination by the court of the concept of "management of SIFs" where the service is provided by a third party using an IT platform; the question of "specificity" of the service could then be considered in the context of modern technology. However, the way the UT had framed the questions meant that this was not possible within this case. Instead, it was necessary only to consider whether the single supply could have two liabilities.

The UT had based its questions on the premise that the services constituted a single supply comprising several elements. The Commission considered that there was a single supply that was not capable of subdivision. The A-G reviewed the precedents that emphasised that a single supply should not be artificially divided – *Card Protection Plan*, *Mesto Zamberk* and *Stadion Amsterdam*. Although there were different elements in the Aladdin service that might in theory be provided separately (market analysis, monitoring performance, risk assessment, monitoring regulatory compliance and implementing transactions), the value to the recipient was in the combination of all of them together, none of which predominated. It therefore appeared that this was a single supply.

The only cases in which the CJEU has recognised apportionment of a single supply were *Talacre Beach Caravan Sales* and *Commission v France* (the undertakers' case). The A-G considered that these did not establish general principles and were therefore not applicable. They were limited to their facts and the legal provisions that gave rise to them (zero-rating in the UK and the lower rate in France).

The judgment in *Luxembourg* on which the company relied was also not applicable. Art.132(1)(f) specifically refers to a "share" of costs, which suggested that apportionment might be available. There was no similar

language in art.135(1)(g). The court was answering specific questions in a restricted context, and it would be wrong to extend the conclusions to the present situation.

The A-G went on to consider whether there was an argument based on fiscal neutrality for the supply to be split where a minority of a service was used to manage SIFs, given that if it was used only for management of SIFs, it would be exempt. In his view, this would compromise the objective of the exemption, which was focused on supplies solely used for the management of SIFs. Fiscal neutrality could not override the law, and exemptions had to be interpreted strictly.

The use of the value of funds managed as a basis for apportionment was also rejected. The liability of the supply would vary according to factors that were nothing to do with the supply, which would be unworkable. Case law supported an approach which followed "practicality over accuracy": it was either impossible, or otherwise very difficult, to determine the proportion in which the services were used for SIF management, so treating the single supply as wholly taxable was the simplest outcome.

The A-G concluded by recommending that the court should find this supply wholly taxable, but also emphasised that the answer might be different if a similar supply was used by an investment manager solely to manage SIFs.

Full court judgment

The CJEU noted that the question of whether there was a single supply was one that was for the referring court to determine, as it was not for the CJ to classify the facts of the dispute. The Advocate-General had considered the question, but the full court proceeded on the assumption that there was a single supply.

The court did consider the difference between two types of "single supply": one where there is a principal element and an ancillary element, and one where there are inseparable elements of a single supply. The UK's case stated that the principal element was "services for the management of investments generally" and the supply of SIF management was ancillary to that; however, the UK had not identified separate elements of the supply that could be principal and ancillary. Rather, it was a distinction between two uses, not between two supplies. There was in reality one supply, which could only be subject to one rate of tax.

The court dismissed the suggestion that the *Luxembourg* decision was relevant. The exemption in art.132(1)(f) is dependent on the recipient of the supply; the exemption in art.135(1)(g) is dependent on the nature of the service. There was therefore no ground for dissociating the tax treatment of a single supply of investment management according to its use.

The court did not accept the proposition that the liability of the supply should be determined by the majority value of the funds under management. According to the UK's argument, the reverse charge applied to the whole cost because the majority of funds were not SIFs; the court rejected the implication that the reverse charge would not have applied if the majority had been SIFs.

The court then ruled that the supplies were not "specifically for the management of SIFs", because the services could be used in the same way for management of other investments. That meant that they were not, in any case, eligible for exemption.

CJEU (C-231/19): *BlackRock Investment Management (UK) Ltd v HMRC*

2.3.2 Updates to HMRC Manuals

HMRC have added guidance to their *Cost Sharing Exemption Manual* for application of the exemption to cost sharing groups in the social housing sector and social housing organisations.

CSE1075, CSE1060

HMRC have updated the guidance in the *VAT Health Manual* to replace references to "Primary Care Trusts" with "Clinical Commissioning Groups", which now provide primary care services to bodies in the UK.

VATHLT1080 and other sections

2.4 Zero-rating

2.4.1 Books etc.

HMRC have published new internal guidance on the scope of the zero-rating of electronic publications that came into force on 1 May 2020. This sets out HMRC's interpretation of a number of the key phrases in the legislation, including "supplied electronically" and "wholly or predominantly devoted to advertising, audio or video content", as well as issues such as the treatment of subscriptions and supplies spanning the change of rate.

The relevant Notice has also been updated with a new section 9 devoted to the new rules.

Notice 701/10; VBOOKS8490 – VBOOKS8520

2.4.2 Charity advertising

Following discussions between the Charity Tax Group and HMRC, a Brief has clarified and relaxed the circumstances in which HMRC will allow zero-rating for charity advertising. The key issue is that HMRC have disallowed zero-rating where the charity has been considered to have "selected" the target of the advertisement, which has resulted in some internet advertising being treated as standard rated. This was previously discussed in *R&C Brief 25/2010*.

The following situations are now regarded as zero-rated, provided the other conditions are met:

Audience targeting

The use of demographic, behavioural and other third-party data to identify a target audience and placing advertisements related to that data as they browse elsewhere.

Behavioural targeting

Using cookies to identify people who have visited websites or made searches related to particular areas of interest and placing advertisements for related goods and services which are displayed as they browse elsewhere.

Channel targeting

The selection of a specific section of a website on which to place advertisements.

Content targeting

Selection of specific content for advertisements to appear alongside.

Daypart targeting

Advertisers choose to target only specific times of day or specific days of the week, without any decisions involving recipients. This is because their advertisements are more relevant to those periods.

Demographic targeting

Use of data from a number of sources, including logged in and behavioural data, to identify target audiences. The advertisements will be related to that data as they browse elsewhere.

Device targeting

Advertisers choose to reach only certain types of device.

Direct placements on third party websites

Placing an advertisement on a website without any decisions involving recipients. The choice of website is the main consideration.

Location targeting

This is similar to behavioural targeting. When individuals opt in to provide location data, this information is collected and combined into large datasets to target audiences who have visited particular areas. Advertisements relating to that data are then displayed as they browse elsewhere. No personal data or survey results are collected.

Lookalike targeting

Using cookies to identify potential new customers by looking at common traits and behaviours of existing customers.

Pay-per-click adverts

Used to encourage people browsing to click on an organisation's link in precedence to other links shown. The search engine receives a fee every time the organisation's website is accessed through the sponsored link.

Retargeting

Use of cookies to track users and find them again when they browse the internet.

If an advertisement qualifies for zero-rating, the copyright, design and production services will also qualify. VAT Notice 701/58 *Goods or services supplied to charities* provides more details. However, services supplied by copywriters and designers for the purpose of search engine optimisation, structuring a website so that it contains as many keywords as possible, do not qualify for the zero rate. These services involve the optimisation of a charity's own website and are specifically excluded from the relief.

The following are still regarded as standard rated:

Email advertisements

Advertisements sent to email addresses are targeted at the individual recipient and are therefore excluded from zero rating.

Natural hits

The listing of a charity in the results of a search engine. This happens automatically regardless of any action taken by or on behalf of the charity and just highlights text from the charity's own website. Such results are not considered advertisements for VAT relief.

Social media/subscription website accounts

When individuals log in to their personal pages, sites use tools to apply advertisements to them when they are signed in. The content will be related to the individual's known likes, dislikes, interests or location, as a signed in member of the website.

The Brief invites claims for repayment where supplies covered by the new policy have been treated as standard rated, subject to the normal rules on such claims. This means that the trader who made the supply will have to make the claim, and will have to undertake to refund the money to the charity that bore the cost.

Revenue & Customs Brief 13/2020

2.4.3 PPE relief extended

The *Value Added Tax (Zero Rate for Personal Protective Equipment) (Extension) (Coronavirus) Order 2020* has extended the temporary VAT zero rating of supplies of personal protective equipment from 31 July 2020 to 31 October 2020. The relief is in VATA 1994 Sch.8 Group 20.

SI 2020/698

2.5 Lower rate

2.5.1 Insulated roofs

Another case has come before the FTT on the supply of insulated roofing panels. The company appealed against assessments for £2,581,092 in respect of supplies charged at 5%, when HMRC considered they were standard rated, from 12/17 to 12/19. By the time of the hearing, HMRC had accepted that some assessments for earlier periods were out of time, and a separate appeal for the 03/19 period had been added to the list, with a hardship application accepted by HMRC.

As the Tribunals have considered very similar supplies in *Pinevale Ltd* and *Wetheralds Construction Ltd*, the company had to show that its supplies were different from those of its predecessors. Judge Rachel Short was presented with examples of the product and a "*Pinevale*-type" roofing panel, as well as information about design and fitting from marketing material.

The company's managing director gave evidence that the roofing panels insulated an existing roof and did not replace the roof structure. He

highlighted a number of differences between his company's products and installation procedures and those employed by Pinevale and Wetheralds. He regarded both of those companies as essentially providing a new roof, whereas this appellant's supply was only of insulation, fitted to the existing roof.

HMRC accepted that the supplies were different, but pointed out that the insulated panels replaced the existing panels; without them, there would be no roof. They therefore were "the roof itself" and had to be subject to VAT at the standard rate.

The judge considered that HMRC's argument was stronger. The distinction was between the supply of "something for a roof" and "a roof". In her view, these roofing panels were "a roof". The attempts to distinguish the situation from *Pinevale* did not succeed. Although significant elements of the existing roof were not replaced, nevertheless what was supplied was "a better roof". Clearly the function of the product was to provide insulation, but that did not bring it within the legislation.

The appeal was dismissed. As the case had been categorised as complex and the company had not opted out of the costs regime, it may have a further liability over and above the VAT.

First-Tier Tribunal (TC07828) *Greenspace Ltd*

2.5.2 Temporary rate cut

Exceptionally, the Chancellor's announcement on 8 July was covered in the July update, which normally only includes developments up to 30 June. As July naturally belongs in the October update, the item from July is reproduced here.

On 24 September the Chancellor extended some of the fiscal measures to support businesses through the pandemic; this included extension of the reduced rate from its original end-date of 12 January to 31 March 2021. The following note has been amended to reflect the rules as they now stand.

One of the measures on 8 July introduced in the Summer Fiscal Statement to stimulate the economy is a targeted temporary VAT rate cut, which is described in detail in a Revenue & Customs Brief. The following supplies will be charged at 5% instead of 20% from 15 July 2020 to 31 March 2021:

- food and non-alcoholic beverages sold for on-premises consumption, for example, in restaurants, cafes and pubs;
- hot takeaway food and hot takeaway non-alcoholic beverages;
- sleeping accommodation in hotels or similar establishments, holiday accommodation, pitch fees for caravans and tents, and associated facilities;
- admissions to the following attractions if they are not already eligible for the cultural VAT exemption:
    - theatres
    - circuses

- fairs
- amusement parks
- concerts
- museums
- zoos
- cinemas
- exhibitions
- similar cultural events and facilities

Where admission to these attractions is covered by the existing cultural exemption, the exemption will take precedence.

Revenue & Customs Brief 10/2020

Further information is available at www.gov.uk/guidance/vat-reduced-rate-for-hospitality-holiday-accommodation-and-attractions.

This will pose various challenges for eligible businesses, particularly if they have previously only made supplies that have been chargeable at the standard rate. They will have to identify those supplies that can be charged at 5% and make sure that the correct rate is charged on those supplies that are still charged at 0% (e.g. cold takeaway food) or 20% (e.g. alcoholic drinks). It may be necessary to reprogram tills, or to consider the effect on retail scheme calculations.

Businesses will also have to decide whether to adjust their selling prices to reflect the reduction in VAT. There is no obligation to do so: the idea of the tax cut is to stimulate demand, but if the trader is confident that the demand will be there, the result is to support profits because a higher proportion of the takings are retained. It is a commercial decision -not a tax rule – that may be affected by the cost or inconvenience of changing price lists, for example on printed menus.

If the business wishes to pass on the whole of the tax reduction to customers, the reduction from 20% to 5% represents a 12.5% cut in the VAT-inclusive price – a selling price of £10 falls to £8.75.

The most technically complicated rule on a change of VAT rate applies where the tax point for the supply has been advanced by the issue of a tax invoice or the receipt of payment. This could apply where businesses have received advance bookings before 15 July for supplies that will take place afterwards. The receipt of money or the issue of a tax invoice normally moves the time of supply to that date, which means that the liability of the supply would be fixed at 20%; however, under VATA 1994 s.88, the trader may ‘elect’ to apply the ‘basic tax point rule’ instead and account for only 5%. The timing of the liability to pay HMRC is still based on the date of receipt, but the amount due can be reduced. The trader ‘elects’ simply by applying the rule – there is no paperwork involved.

These rules are described in detail in the VAT Guide section 30 (Notice 700. If a VAT invoice has been issued showing tax at 20%, a credit note has to be issued, which means that the benefit of the reduction goes to the customer. If no VAT invoice has been issued, it is up to the trader to

decide whether to make a refund to the customer – it is not required by the law. If standard rated VAT has already been accounted for on a VAT return that has been submitted, an adjustment to output tax can be made on the next return.

When the rate goes back up from 5% to 20%, it is normally permissible not to 'elect' to apply the changed rule, where an invoice or receipt falls before the change. The ATT Q&A covered below at 2.5.4 confirmed that the government has no plans to introduce anti-forestalling legislation: it will be possible to book a holiday for summer 2021 before the rate rises again, and benefit from the reduced rate.

The legislation introducing the change (*The Value Added Tax (Reduced Rate) (Hospitality and Tourism) (Coronavirus) Order 2020*) was published on 14 July. It includes a table of revised Flat Rate Scheme rates, which of course are significantly different for affected businesses that continue to use the FRS.

SI 728/2020

HMRC have updated their Notice *Land and property* to reflect the temporary reduced rate of VAT on supplies of hotel and holiday accommodation.

Notice 742

HMRC have also updated the following Notices:

- *Notice 701/14 Food products*
- *Notice 709/1 Catering, takeaway food*
- *Notice 709/3 Hotels and holiday accommodation*
- *Notice 709/5 Tour Operators Margin Scheme*
- *Notice 727 Retail schemes*

The issues associated with retail schemes are considered in section 2.6 of this update.

2.5.3 Articles

In an article in *Taxation*, Richard Curtis discusses the summer fiscal statement and the Chancellor's attempts to re-start the economy.

Taxation, 16 July 2020

In another article, Neil Warren examines the issues surrounding the application of the lower rate in more detail. For example, the reduced rate applies to many tourist attractions but not sporting events. Retailers will have to apportion supplies between those newly qualifying for the reduced rate (eat-in and hot takeaway food), those that qualify for the zero rate (cold takeaway food) and those that continue to be standard rated (alcoholic drinks).

Taxation, 23 July 2020

2.5.4 Technical responses

The ATT technical officers raised a number of queries on the practical application of the temporary reduced rate, and HMRC's helpful replies are

set out in a document available online. This includes the following points:

- a "gin and tonic" is a single alcoholic drink;
- low alcohol drinks are treated as "soft" if there is no excise duty on them;
- a promotional offer of "a free pint with a burger" would have to be apportioned between 5% and 20% in accordance with economic reality;
- sales of "excepted item food" for consumption on the premises will be charged at 5%, but will remain 20% if for takeaway;
- "on the premises" only covers the supplier's own premises, not a supply of catering where the supplier travels to the customer.

There are also several points where the ATT officers have raised issues with HMRC's guidance and requested clarification.

www.att.org.uk/technical/news/hmrc-response-att-queries-temporary-reduced-rate-vat

2.6 Computational matters

2.6.1 Retail schemes and reduced rate

HMRC have published further guidance on retail schemes and the temporary reduced-rate. They recognise a number of potential difficulties:

- for those using EPOS or ordinary point of sale schemes, tills may not be capable of introducing a new rate of VAT, particularly where previously a retailer has only made SR sales.
- where a business operates a bespoke retail scheme or agreed estimation, which obviously will not take into account reduced rated supplies, it may be difficult to agree amendments to the schemes in time for the change in VAT rate. Although HMRC would not usually consider retrospective changes to a BRS, this may be necessary due to the short timescale from notification to implementation of the reduced rate. Should retailers require an amendment to a BRSA or agreed estimation they should contact HMRC as soon as possible outlining the issue and providing potential fair and reasonable solutions.
- a takeaway meal could be at three different rates, e.g. cold sandwich, hot coffee and chocolate biscuit. A "meal deal" offering a single price for a package will require apportionment on a reasonable basis.

The guidance includes a number of illustrative scenarios and worked examples to help retailers understand how the rules are meant to work.

VRS13010 – VRS13040; VRS11300, VRS3455

2.7 Discounts, rebates and gifts

2.7.1 Eat Out to Help Out

The Chancellor's scheme to encourage people to go back to the catering industry has been a great success. Meals sold up to 31 August qualified, and claims had to be submitted by 30 September, so it is now "closed" and the guidance has been withdrawn. The key point that remains of relevance is that money received from the government for meals sold is subject to VAT (presumably at 5% or 1/21, on the basis that the reduced rate and the discount appear to apply to the same supplies). It is "third party consideration" for the catering supply.

www.gov.uk/government/publications/get-more-information-about-the-eat-out-to-help-out-scheme/get-more-information-about-the-eat-out-to-help-out-scheme

2.8 Compound and multiple

2.8.1 Car hire and child seats

The supply of a child car seat is subject to the reduced rate. This covers hire as well as sale. A car hire company claimed repayments by voluntary disclosure totalling £631,000 for periods from 1 October 2008 to 31 December 2015 on the basis that it had accounted for standard rated VAT on the total receipts from rentals that included child car seats, and it should have accounted for less output tax on the specific extra charges that were received for the seat.

The Tribunal examined the way in which car seats were offered, the relative costs of car hire and seat hire, and the relatively low cost of buying a new seat (apparently equivalent to the charge for about three days' hire). A very small proportion of customers rented a seat; they booked it in advance by following a section marked "extras" on the website and paid a clearly disclosed extra fee.

HMRC submitted that "the aim of the customer" was to "hire a car in which all the passengers can be transported safely and legally". The hire of a child car seat was not "an aim in itself". They cited various points arising from the principles in the *Middle Temple* case in support of the argument that there was a compound supply:

(1) it is not possible to hire a car seat without first hiring a car;

(2) car seat hire with car hire was rare;

(3) there is no separate contract for the car seat;

(4) car seats are not advertised separately;

(5) the period of car hire and car seat hire is generally coterminous; and

(6) it was irrelevant that customers installed the car seats themselves.

The company's main argument was based on the customer's freedom of choice: they could bring their own car seat if they wished. The fact that

the customer fitted the seat into the car themselves was argued to be significant, as it showed the separateness of the two supplies.

The judge considered that the two supplies were economically distinct. Although they were linked, they were not so closely linked as to become a single indivisible supply. There was a genuine economic choice for the customers to bring their own seat; if they chose to hire one, it was only for the convenience of not having to travel to the point of hire while carrying their own.

The fact that the car seat could not be hired on its own, without a car, was not conclusive. That was similar to the car insurance in the *BGZ Leasing* case, where the CJEU considered that the fact that something facilitated enjoyment of the main service did not necessarily make it an ancillary or incidental supply. As with the insurance in that case, the seat had a distinct and separate aim for the customer – to enable safe and legal transportation of children.

The judge (Zachary Citron) concluded that "this is a case where the 'normal' rule under principle (1) applies – i.e. the supplies are to be regarded as distinct and independent – because the car hire and car seat hire are, from Car Seat Customers' perspective, neither so closely linked that they form a single, indivisible economic supply which it would be artificial to split, nor in a principal/ancillary relationship such that car seat hire is not an aim in itself but a means of better enjoying the car hire."

The appeal was allowed.

First-Tier Tribunal (TC07733): *Europcar Group UK Ltd*

2.8.2 Skates on?

In TC06117, the FTT allowed an appeal by two companies that supplied packages of allowing a child to hire skates and skate on its ice rinks. The hire of skates to a child on its own would be zero-rated; the question was whether any part of the package deal could be zero-rated.

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

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

The company put forward a number of arguments that the supplies were separate. Neither supply was predominant and neither was ancillary. The pricing clearly distinguished between the two elements. There was also

an argument that the *Talacre* principle might apply to a single supply in this area – that even a compound supply could be partially taxed at the zero rate.

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

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

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

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

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

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

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

The judge made the following highly critical comments:

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

119. Even odder was the decision to apply this guidance (or to have it applied by specialists for him) to the companies in this case without any attempt to discover whether there were any differences between PIB's operations and that of the appellants and without visiting their operations or talking to their management. Indeed all he asked the appellants was

whether their exempt or zero-rated sales covered children's ice skates, and on the basis of their confirmation he justified his assessments.

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

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

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

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

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

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

HMRC appealed to the Upper Tribunal, arguing that the FTT had made errors of law, and the supply should be regarded as a package that did not qualify for zero-rating. The company submitted arguments that, if HMRC were successful in their contention that there was a single standard-rated composite supply, it would still be possible to carve out a zero-rated element (i.e. appealing against the FTT decision on the *Morrisons/Colaingrove* point).

HMRC's argument was that the FTT should have considered the viewpoint of a purchaser of the package, rather than the viewpoint of an average customer. Someone who did not own skates would surely regard the package that they purchased as a single supply that it would be artificial to divide; it was irrelevant that other customers brought their own skates, because they were receiving a different supply.

The company accepted that this was a valid argument, but responded that it was necessary to consider all the circumstances, which would include the range of options available even if a person without skates would buy the package.

The UT started by analysing the significance of the "typical consumer" in *CPP*. The consideration of the typical consumer was to assist in identifying precisely what has been supplied and whether that amounts to a single composite supply or several separate supplies. It therefore necessarily follows that the "typical consumer" must be a recipient of the package whose characterisation is in dispute, and not simply a general customer of the business.

The UT considered that arguing by analogy from decisions such as *Levob* and *Deutsche Bank* was not particularly helpful because of the different contexts (customised software and investment management services). The principles the UT derived from CJEU precedents were set out as follows:

(1) The ECJ has not given exhaustive guidance that covers all situations.

(2) Every supply must normally be regarded as distinct and independent, although a supply which comprises a single transaction from an economic point of view should not be artificially split.

(3) Given the nature of the supplies at issue in this appeal, we consider that the Levob line of authority is more relevant. Since skating cannot be enjoyed without both access to an ice rink and a pair of ice skates, the question of which element of a skating with skates package is "principal" and which is "ancillary" is unlikely to be of much assistance in determining whether the skating with skates package involves single or multiple supplies.

(4) Therefore, a relevant question in this appeal is whether the constituent elements of a skating with skates package as supplied to a typical customer of that package are so closely linked that they form, objectively, a single, indivisible economic supply, which it would be artificial to split.

(5) The question in paragraph (4) above must be answered by reference to all the circumstances in which a supply of skating with skates takes place.

(6) If a typical consumer has a choice as to whether or not to purchase one or more constituents of a skating with skates package, that is a relevant circumstance. If the freedom to choose is genuine and reflects the economic reality of the arrangements between the parties, it will be an important factor.

(7) If a skating with skates package involves a single supply, then the question of whether that single supply is standard-rated or zero-rated would fall to be determined by considering whether the supply of the children's skates, or the supply of admission to the rinks predominates. However, Ms Brown was not seeking to argue that, if there was a single supply, it was zero-rated and therefore we will not consider this issue any further in this decision.

The UT concluded that the FTT had followed the wrong approach, in that it had considered the views and choices available to all customers of the companies. It should have concentrated on those customers who came without skates and who therefore bought the package. The taxpayer's counsel argued that the FTT had considered the real options available to customers, but the UT held that the FTT would have had to have had some evidence to support a conclusion that those options (e.g. buying skates at the last minute) were realistic rather than wholly artificial. It did not appear that any such evidence was provided, and the FTT certainly did not draw any conclusions from such evidence.

In their cross-appeal, the companies tried to distinguish between the wording of VATA 1994 s.29A and s.30, in order to support an argument that zero-rated supplies could more easily be "carved out" of single composite supplies than lower rated supplies such as those considered in *Morrisons* and *Colaingrove*. The UT did not accept that such a distinction was justified. The principles were the same, and part of a composite supply could only be given a different liability if the law explicitly provided for it. The FTT had come to the correct decision for the correct reason.

The UT decided that the proper course was to remit the case to the same FTT for consideration of evidence on whether the options available to a purchaser of the package were realistic and relevant in deciding whether it

would be artificial to divide the package into two supplies. In deciding to remit, the UT emphasised that it had not criticised the FTT's decision in such a way that the reconsideration might be prejudiced.

The same panel (Judge Richard Thomas and Simon Bird) heard the remitted case by video link. They noted the case law cited by the UT, and commented that the "normal rule" is that each supply is given its own treatment; they also noted that "*CPP* was a principal/ancillary case, which this is not". The UT had commented that HMRC did not dispute the facts found by the FTT, so they were rehearsed with some extra clarification where necessary.

The FTT heard further evidence from a consultant to the appellants, described as an expert witness. In the first hearing HMRC's counsel had challenged much of his evidence and the judge said that he had given his opinions and speculations "such weight as we think appropriate having regard to these criticisms". The new decision includes statistical information gathered by the consultant from customer surveys to determine the attitudes and objectives of customers who bought the package. The judges made various comments on the conclusions to be drawn from the consultant's tables, accepting some conclusions and rejecting or modifying others.

Not surprisingly, given that the case had been remitted, the FTT goes through the arguments in considerable detail. The judge comes to the conclusion that the "normal rule" should be followed if the "typical consumer" has a "realistic choice" at the time that choice is exercised; that would not only be at the counter of the ice rink, but also when booking online in advance. There clearly was "genuine contractual freedom" at the point of buying the package: having skates was necessary to have access to the ice, but hiring skates was not. The question was whether the option was a realistic possibility, or if it "entered the realms of the artificial" (as would buying customised software separately from the computer disk in *Levob*). If it was more likely than not that a not insignificant number of people chose to exercise the choice to obtain their own skates, then the choice was realistic and it would not be artificial to divide the supplies. The judge was satisfied that this was the case, and allowed the appeal again.

Perhaps the strongest argument for HMRC was the difference in price between skate hire (£2) and the cheapest skates available to buy (£35, even if the cost of sharpening was ignored). The judge agreed with the consultant that this was not a matter of pure economics; the quality of the hire skates was basic, and children might press their parents to buy them their own skates.

First-Tier Tribunal (TC07829): *The Ice Rink Company Ltd and another*

2.8.3 Article

In an article in *Taxation*, Waqar Shah and Robert Hartley discuss the treatment of multiple supplies, with particular reference to the above cases and the ice rink case that is still awaiting the further decision of the FTT on supplies of access to the facilities together with hire of children's skates.

Taxation, 30 July 2020

2.8.4 Opticians

In October 2017, the FTT heard an appeal (TC06192) by DCM (Optical Holdings). It concerned a dispute with HMRC about the calculation of output tax on the sale of spectacles and dispensing services. HMRC's approach was set out in Information Sheet 08/99, which consolidated guidance on the apportionment of charges for supplies of spectacles and dispensing. The Information Sheet sets out the two methods of apportionment open to opticians, namely Full Cost Apportionment ("FCA") and Separately Disclosed Charges ("SDC"). If the requirements for SDC are not met then FCA is the only other alternative.

Judge Anne Scott considered the history of the dispute and the way in which it had been conducted, and concluded by striking out all six appeals brought by the company. The appeals moved on to the Upper Tribunal in late 2018.

The Upper Tribunal noted that DCM had been in dispute with HMRC over a number of issues over many years. Various input tax disputes have now been resolved, and were therefore not directly relevant to the current proceedings; however, they were noted as one of the reasons it had taken so long for the present dispute to reach the Tribunal.

DCM had conceded one of the disputed output tax issues before the hearing. The issues that remained were:

- the information that had to be disclosed by DCM to customers in order to qualify for a "separately disclosed charges" method under IS 08/99;
- the allocation of customer discounts between exempt and taxable output supplies.

The appeals related to assessments for underpaid output tax in periods 10/02, 01/03, 04/03 and 07/03, and decisions taken in 2013 amending repayment claims for periods between 07/05 and 12/08.

The grounds of appeal were:

1. HMRC had no power to "amend" a repayment return – they could only raise an assessment, which they had not done within any applicable time limit.
2. Contrary to HMRC's assertion, the company had operated a SDC method that complied with IS 08/99 up to February 2004.
3. It was appropriate to allocate discounts against taxable supplies of goods, and HMRC were wrong to apportion the discounts to taxable and exempt supplies.
4. The assessments for periods from 10/02 to 07/03 were made out of time.

In respect of issue 1, HMRC argued that the time limits in s.73 only applied where an error in a return produced an amount due from the taxpayer. In relation to a repayment return, the FTT had accepted that HMRC could effectively refuse to repay at the conclusion of an investigation without having a particular time limit to satisfy; the FTT was also satisfied that the officers concerned had carried out their

investigation in a proportionate way against the background of a lack of cooperation by the taxpayer.

The UT considered the arguments and agreed with HMRC and the FTT. The right to refuse a repayment claim was implicit in HMRC's care and management powers; there was a right of appeal against a decision to refuse or reduce a claim, and a right to apply for judicial review where a decision was unreasonably delayed, but s.73 had no application.

On the SDC issue, the UT noted that documents purporting to be examples of the company's receipts issued to customers before 2004 were only provided to HMRC on the Friday before the FTT hearing was to start on Monday 26 September 2016. There was argument about whether they should be admitted, but in the end they were considered by the judge. The FTT concluded that they did not comply with the IS because they only referred to "services", not to "dispensing". Accordingly, the FTT held that the company did not have a compliant SDC method until it changed its documentation in February 2004.

The UT disagreed with the FTT. There was no possible candidate for "services" other than "dispensing"; in conjunction with notices displayed prominently in the company's shops, it was clear what the documents meant. The changes in February 2004 did not add anything of substance. The UT was satisfied that the FTTs' conclusion, even though it appeared to be one of fact, was so unsupported by the evidence that the FTT had found that it amounted to an error of law. The UT therefore held that the information provided to customers before February 2004 did comply with the IS, and expressed regret "at the least" that appropriate evidence of this was not provided to HMRC until just before the hearing.

Turning to the discounts issue, the FTT decision did not gather all the findings in one place. The UT noted a number of different findings that related to the discounts, and concluded that the FTT had applied the right test: it had agreed with HMRC's representative that the company was entitled to allocate the discount entirely to the goods, but that there was insufficient evidence that this had been done. In particular, the company appeared to offer "free eye tests", but then allocated no discount to the exempt charge for the eye test on its documentation. The earliest documentation did not allocate the discount between taxable and exempt supplies at all. Accordingly, the UT decided that there was no reason to interfere with the FTT's conclusion in this area.

The time bar issue related to assessments raised on 20 October 2005 more than two years after the end of the relevant periods. The company argued that HMRC had had sufficient information on which to base these assessments for more than 12 months by that date, and were therefore out of time. The FTT had expressed itself "wholly unable to see any material fact which was known to HMRC prior to 31 August 2005 which would have justified making the assessment earlier", and had therefore rejected this ground of appeal.

HMRC argued that the company was wrong to assume that the time bar only operated on the specific information relevant to the output tax assessment. In their view, a piece of information relating to an input tax overclaim could open up an unconnected output tax under-declaration in the same period, even if the latter would, on its own, have been time-barred. However, in this case the FTT had been correct to find that the

"last piece of the puzzle" was not provided to HMRC until a meeting on 31 August 2005, so even on its own, HMRC argued that the output tax assessment was in time.

The UT agreed with HMRC's view that an assessment is a "unitary demand for tax", so information about an input tax issue could keep open a period for assessing output tax. However, it was necessary to consider the assessment that was actually raised, and the information used to raise it. The information provided at the meeting in August 2005 was not the basis for the assessment, which was rather the difference between the officer's best judgement calculations of output tax and the figures on the company's VAT returns. The way in which those VAT returns had been calculated was not relevant to the assessment. The UT was satisfied that HMRC had had all the relevant information for more than a year before October 2005, and the assessment was out of time in relation to the periods in issue.

The company's appeal was therefore allowed in respect of issues 2 and 4, and refused in respect of issues 1 and 3.

The dispute has now moved on to the Court of Session. Although the UT had only given HMRC leave to appeal on one ground, a year ago the CS decided that it would be reasonable to allow both parties to appeal on both the grounds that they put forward.

The judges go through the history of the dispute, and start with HMRC's appeal on the time bar issue. The reasoning of both the FTT and the UT is examined; the judges accept HMRC's argument that the UT erred in law by substituting its own interpretation for the findings of fact of the FTT. There was no justification for overriding the FTT's conclusion that the officers could not have raised the assessment before the meeting in August 2005. HMRC's appeal on this issue was well founded.

DCM appealed on the question of HMRC's right to amend a repayment return without raising an assessment. The company raised a new argument that did not appear to have been discussed in the FTT or UT: that HMRC could only amend a return by exercising a statutory power, and that was either to raise an assessment under s.73 or to instruct the company to make a correction under reg.35 SI 1995/2518. The judges considered that HMRC clearly had the right to refuse to repay an input tax claim if they did not accept it, and there were remedies available to the taxpayer in such a situation. They did not consider it necessary to rule on the scope and construction of reg.35. This ground of appeal was dismissed.

The company also appealed on the discounts issue, arguing that consideration for a supply was a subjective matter rather than an objective one, and it was free to allocate discounts as it saw fit. The judges agreed that there had been an error of law in that the FTT appeared to believe that an objective basis of allocating the discount was required; however, the UT had correctly concluded that the decision was correct. If there had been an agreement between the parties at the time of supply concerning the allocation of the discount, that would have determined the matter (as the officers concerned had accepted); but there was no evidence that such an agreement existed. The FTT had made (and had been entitled to make) a number of findings of fact which suggested that exempt services were discounted.

HMRC's appeal was allowed, reinstating the assessments of 20 October 2005. DCM's appeals were dismissed.

Court of Session: *DCM (Optical Holdings) Ltd v HMRC*

2.8.5 Opticians and hearing aid dispensers

HMRC have revised their policy on how opticians and dispensers of hearing aids account for VAT on their supplies. The changes will take effect from 1 October 2020.

Opticians and dispensers of hearing aids make two supplies to their customers for VAT purposes: the spectacles, lenses or hearing aids themselves which are taxable at the standard rate, and a supply of dispensing services which is exempt from VAT.

To account for VAT on the taxable element of their sales, opticians and hearing aid dispensers may either:

- use separately disclosed charges for each supply, notifying each separate charge to the customer at the time of sale, or
- charge a single price to the customer and make a fair and reasonable apportionment of the income between the taxable and exempt elements of the supply, using a method of their choice, which has previously had to be approved by HMRC.

There has up to now been no uniform standard of evidence required from businesses to show that they are making separately disclosed charges. In order to simplify the process, from 1 October 2020, businesses will be required only to hold a till slip or similar evidence to demonstrate that they are making two separate charges to the customer at the time of supply, and that this information is being conveyed to the customer.

Those using a method of apportionment will no longer have to seek prior approval from HMRC before operating a method. This will bring opticians and dispensers of hearing aids into line with other businesses that apportion VAT on their sales.

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2.8.6 Article

In an article in *Taxation*, Kevin Hall and Punnit Vyas highlight some practical issues arising from the supply of wedding packages. These include the question of compound and multiple supplies (the exemption for supplies of land is unlikely to apply to the venue hire), and the application of the reduced rate for accommodation. Catering supplied by a hotel in the hotel's premises will qualify for the reduced rate, but catering supplied by an outside caterer at a separate venue will not.

Taxation, 24 September 2020

2.9 *Agency*

2.9.1 Net or gross?

In TC06845 (late 2018), a company ran a website offering services to students, including writing essays and coursework for them. The identity of the client and the identity of the person writing the work were not known to each other. The judge noted that the terms and conditions that clients were required to agree to were obviously drafted with the intention that the website would be regarded as acting as an agent arranging a transaction between the other parties; the question was whether that reflected the economic reality.

The judge considered that the terms and conditions contained a number of "glaring examples of artificiality and disingenuousness". The website purported to offer educational services, prohibiting the submission of the work as if it was the client's; it was obvious, and acknowledged at the hearing by the appellant's witness, that the clients were obtaining essays to hand in and pass off as their own. The contracts between the appellant and the clients, and the appellant and the writers, purported to impose a liability of £5,000 from the writer to the client if the client (or, presumably, his/her tutors) detected plagiarism in what was supposed to be "original work".

The judge (Geraint Jones) described the business model in very robust terms: "it assists those who have little or no academic ability and/or are lazy, to cheat. It is beyond doubt that the appellant's business thrives upon providing essays, dissertations and coursework to cheats." Against that background, the judge was satisfied that the contractual documents, which were designed to prevent the client and the writer ever having contact with one another or even knowing each other's identity, were designed to disguise the nature of the business and, in turn, deflect attention from it being unethical. However, the judge did not suggest that it was illegal, and the judge acknowledged that HMRC were not arguing that any part of the contractual documents was a sham.

HMRC argued that the economic reality was that the appellant provided the service and used the writers as subcontractors. The appellant argued that the Tribunal should look no further than the contracts, which on their face provided that it was an agent arranging a contract between the principals.

The judge considered the evidence of how the business was run and the contracts, and concluded that, when the matter was considered in the round, there was in reality a supply from the appellants to the clients. This decision was based on the following factors:

- the impression that a person visiting the website would obtain;
- the efforts made to make sure that the two "principals" did not know the identity of the other;
- the lack of any contract between the two principals, and the lack of any reference in the company's contracts to the extent of its authority as agent;
- the fact that the contract was stated to be "binding on the client" once a suitable expert had been found, and no refund would be issued;

- the fact that the writers were paid by the appellant in its own name and from its own bank account, on invoices raised to the appellant by the writers and without mentioning any relationship of agency.

The economic reality was that the appellant was acting as a principal, and it was therefore liable for VAT on the full value received for its supplies, rather than just the commission it retained. The assessments, covering the periods from January 2012 to September 2015, amounted to just over £900,000.

As the company lost on the "principal" issue, there would have to be a further dispute in due course on whether some of the supplies were outside the scope as received by customers belonging outside the EU. That was not argued before the FTT in this hearing.

The company appealed to the Upper Tribunal (Judge Jonathan Richards and Judge Guy Brannan). The decision starts with more detail on the business model, giving an example of a payment of £240 for a piece of work: ignoring VAT, the company retained £160 and the writer was paid £80. The company posted details of requested assignments on a portal to which the writers had access, inviting them to indicate if they were willing to undertake the work for the fee stated (only the writer's share was shown). It was important for two reasons to keep the identity of the writers confidential: they would not want their employers to know that they were "moonlighting", and the company did not want the customers to be able to go direct to the writers for future pieces of work.

The company disputed the comments about cheating in the FTT decision; however, the UT did not discuss the issue, beyond saying that all parties were agreed that it was irrelevant to the VAT treatment. The only issue was whether the supply was made as agent or principal.

The UT cited *Newey* as the main precedent for deciding who was the true recipient of a supply, and outlined the following approach as its application of the principles of the CJEU decision in that case:

(1) First, we will ascertain the meaning and effect of relevant contractual terms so as to determine whether those terms impose an obligation on the Appellant or the Writer (or both) to provide the academic work to the Customer in return for the payment that the Customer makes to the Appellant.

(2) Second, we will consider whether the contractual terms reflect commercial and economic reality.

(3) In the light of our answers to questions (1) and (2), we will determine whether the Appellant made a supply of the academic work so as to become subject to an obligation to account for VAT.

The judges started by setting out some legal principles of the law of agency and then examining the contracts. For the company to engage the writers as agents, the writers had to give the company authority to enter into contracts on their behalf. However, that would not be enough on its own; it would also be necessary to consider whether the company was nevertheless liable under its own contracts with customers for the work done by the writers. Both the Writer Contract and the Customer Contract suffered from a lack of clarity as to their precise legal effect, and some of

the provisions contradicted each other. The judges therefore started by analysing the contracts and attempting to resolve the contradictions.

The Writer Contract expressly stated that the company acted as the writer's agent and could bind the writer in contract. There were no limitations on this authority in the contract; HMRC argued from this that the contract was unrealistic. The UT did not agree; the company would have owed a duty to the writers not to exercise the authority unreasonably. Other provisions were consistent with the company engaging the writer as a principal, but were not conclusive in that regard.

Turning to the Customer Contract, there were several clauses that implied the company had responsibility for quality and for timely delivery of work. It appeared that the company acquired the full copyright in the work from the writer, but granted a lesser right to the customer; the judges agreed with HMRC that this supported the conclusion that the obligation to deliver the work rested solely on the company. In addition, if the work did not "meet the ordered grade", the company undertook to refund the fee in full – there was no suggestion that this would be the liability of the writer.

The company's representative relied heavily on an old decision, *Music and Video Exchange Ltd* (High Court 1992), in which a company succeeded in accounting for output tax only on the margin it made on selling second-hand musical instruments on behalf of members of the public. The judges considered the argument, but did not think that the analogy was very strong and the precedent was therefore not of great assistance. Similarly, the company's reliance on the Supreme Court decision in *SecretHotels2 Ltd* was misplaced: the contracts in that case made it much clearer that liability for performance of the contract lay entirely with the hotelier (comparable to the writer) and not with the intermediary (comparable to the company).

The UT noted that the FTT judge had not carried out a detailed analysis of the contracts because he had considered that they were a "smokescreen" that deliberately disguised the true nature of the supplies. The FTT therefore went straight to the commercial and economic reality of the situation. The judges "respectfully considered" that this was not the correct approach. However, in the end the result was the same: the UT concluded that the contracts imposed the core obligations for delivery on the company, and that was consistent with the economic reality. It was not artificial, but it was ineffective. There were flaws in the way the FTT reached its conclusion, but it was correct. The appeal was dismissed again.

Upper Tribunal: *All Answers Ltd v HMRC*

2.9.2 Payments to contractors

A company carried on business in the design, manufacture, supply and installation of bathrooms. It employed some fitters, but also sub-contracted some work to other trusted self-employed traders who were below the VAT registration threshold. When customers paid for a bathroom that was fitted by these external fitters, the company treated the labour element as a disbursement and did not account for output tax on it. HMRC considered that there was a single supply to the customer without

an agency relationship and assessed the company to £22,615 in output tax for periods from 02/12 to 11/15.

The judge noted that there was some inconsistency between the way the business operated according to the oral witness evidence of its director at the hearing, and how it had been described by the company's representatives in correspondence. In the grounds of appeal, the company had stated that customers were aware from the outset when a contractor was to be used, and the customer was involved in the decision whether to engage a contractor or to wait for the in-house team to be available. The director stated that the decision was effectively taken by him after the quotation had been given and the order placed, based on the availability of people to do the work.

The judge accepted that the director was a genuine and honest witness, and therefore preferred his oral evidence. There was also a written statement from one of the fitters that supported the impression that the company engaged him rather than the customer, rather than acting as a co-ordinator in a contract between the customer and the fitter. The Tribunal accepted that defective work was referred back by the company to the fitter who would be responsible for correcting it.

The Tribunal considered the history of the enquiry, which started with a routine visit in August 2015. The accountants complained about the length of time HMRC were taking to come to a decision; protective assessments were issued for 02/12, 05/12 and 08/12 just as the respective four-year time limits were about to expire. A formal notice of assessment covering all the periods from 02/12 to 11/15 was issued by the officer on 1 November 2016 on the basis of calculations he had made on 17 October 2016. The figures included for 02/12 to 08/12 were the same as those notified earlier.

The officer had calculated the underdeclaration for periods from 05/14 to 05/15 by including payments to contractors and treating them as VAT-inclusive. He then extrapolated that proportional underdeclaration back to earlier periods, uplifting the output tax for each period by 10.35%.

Curiously, it was not clear whether the assessments raised before 1 November 2016 were still treated as due and owing by HMRC. The judge commented that they were not the subject of the appeal, and he therefore made no findings in respect of them; only the 1 November 2016 assessments were in issue. He went on to rule that, looking only at those assessments, to the extent that they covered the periods 02/12 to 08/12, they were out of time because they were raised more than four years after the end of the periods concerned. Curiously, both parties argued about whether HMRC had had the relevant information sufficient to raise the assessments for 12 months on 1 November 2016; the judge said that that was irrelevant to those periods. In respect of later periods, the judge accepted HMRC's argument that the visit in August 2015 was not enough to provide sufficient information. The assessments could not have been made earlier than March 2016, so they were in time.

The Tribunal quoted at length from a number of precedents cited in argument on the issue of agency in relation to similar arrangements, before noting that the parties had not referred to the fundamental principle as set out by the Supreme Court in the *Airtours* case: the starting point

was the contracts, which then had to be considered in the light of the economic and commercial reality of the situation.

Those realities were presented quite differently by the parties. The taxpayer's representative submitted that the supplies were made directly by the contractors to the customers and not by the company. The company's own role was as nothing more than an agent for the customers in co-ordinating the fitting works and liaising with the contractors. He said that the contractor was identified at the beginning of the works and the contractual relationship was between the contractor and the customer. There was no contract between the company and the contractors. He accepted that the company controlled the dates of the fitting works but maintained that this was simply a matter of convenience for the different parties involved. Further, the contractors retained control because, if the price was not acceptable, the contractor would not take on the work. Crucially, payment was made directly to the contractor. By contrast, HMRC submitted that the company controlled the whole transaction from start to finish. It was for a set price, the company arranged the dates, and, if there was a problem, the only evidence was that the customers contacted the company rather than the contractor. The contractors' supplies were therefore to the company rather than to the customer.

The judge preferred HMRC's view. Four reasons were given:

- the contract between the customer and the company was for the whole job, including the fitting;
- the decision as to who would do the fitting was taken by the company without reference to the customer;
- the first time that payment to the contractor was mentioned was on the invoice issued to the customer, indicating that it was an instruction to the customer as to the manner of payment of consideration due to the company for the single supply;
- any complaints were made in the first instance to the company, which had overall responsibility for the single supply.

The appeal was dismissed against the assessments for the periods following 08/12, amounting in total to £17,645.

First-Tier Tribunal (TC07753): *Marshalls Bathroom Studio Ltd*

2.10 Second hand goods

Nothing to report.

2.11 Charities and clubs

Nothing to report.

2.12 Other supply problems

Nothing to report.

3. LAND AND PROPERTY

3.1 Exemption

3.1.1 Local authority licences

HMRC have updated their internal guidance on local authority activities and the rent from stalls and pitches. This makes the distinction between certain licensing activities which are regarded as being regulatory and within the public authority regime, in which case they are outside the scope of VAT, and others which constitute the grant of a licence to occupy land, which may be exempt or may be taxable if additional services are involved.

VATGPB8770

3.1.2 Common lease variations

A Brief explains the appropriate VAT and Stamp Duty Land Tax (SDLT) treatment of the most common lease variations between landlords and tenants of commercial properties. There have been no changes to either VAT or SDLT policy, but HMRC state that lease variations have become more frequent as a result of the pandemic, for example where tenants are suffering a loss of income and need to vary the terms of their lease with their landlord. Common variations include changing the amount of rent paid by the tenant (including reduced rent periods and rent holidays) and lease extensions. The notes below reproduce only the VAT section.

A landlord and tenant are free to vary a lease between them in any way they choose. This may benefit the tenant as a:

- period of reduced rent;
- rent-free period;
- rent holiday.

If the tenant makes no payment or a token (peppercorn) fee there is no supply, and so no change in the tax liability of the supply made by the landlord to the tenant.

If, however, the tenant agrees to do something in exchange, this could be classed as a payment for a supply by the tenant to the landlord – unless they are only agreeing to accept the normal responsibilities of a tenant, such as paying rent.

If the tenant agrees to do something more, it is likely that:

- the tenant is making a supply and the rent reduction will be the value of the supply – whether the supply is taxable or exempt will depend on what the tenant agrees to do, in the same way as if they were being paid to do it;
- the landlord must account for the VAT as though the rent was still being paid if they have opted to tax the property.

If both supplies are taxable at the standard rate:

- the amounts of VAT due on each supply are likely to be the same;

- the landlord and tenant will need to issue VAT invoices to each other if either of them is registered for VAT.

The Brief sets out a number of examples:

Landlord reduces the rental amounts payable but there are no other changes to the lease

Where the landlord has opted to tax, they will use the revised amount to account for VAT on the rent that is due. This is because the tenant is agreeing to continue to pay rent under the revised lease and so is not making a supply.

This will also be the case up to, or beyond, the expiry of the lease where the landlord:

- defers the rent by changing the time it is paid, or by paying on deferred terms;
- changes the way the rent is calculated, for example basing the rent on the tenant's turnover or adjusting the rent review arrangement.

Tenant agrees to an extended lease or variation to a break clause in the existing lease

The tenant does not make a supply to the landlord just by agreeing to pay rent under an extended lease. Where the landlord has opted to tax, they will account for VAT on the rent that is due in line with the revised timing and values.

Landlord changes the terms and, in exchange, the tenant agrees to more than paying rent during the lease

The landlord and tenant are making a supply for VAT purposes. For example, the tenant may agree to do some work to the building for the landlord's benefit. The tenant's supply would be a taxable supply of construction services, and the landlord's supply will be a supply of land that is exempt, unless the landlord has opted to tax.

New leases

If the tenant agrees to a new lease with new terms, they are not making a supply to the landlord just by agreeing. The liability of the landlord's supply of the new lease will be exempt, unless both the following apply:

- the landlord has chosen to tax their interest in the property;
- the option is not excluded or disapplied – this is covered in more detail in *Opting to tax land and buildings* (VAT Notice 742A).

As this is a clarification rather than a change of policy, HMRC invite anyone who realises they have accounted for VAT incorrectly to make a correction, either through the VAT return or the error correction process.

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3.2 Option to tax

Nothing to report.

3.3 Developers and builders

3.3.1 Domestic reverse charge

HMRC have published new guidance on the VAT reverse charge for those who buy or sell building and construction services to apply from 1 March 2021. VAT registered businesses in the UK that supply building and construction industry services must use the reverse charge from 1 March 2021 if they meet the following conditions:

- the customer is registered for VAT in the UK;
- payment for the supply is reported within the Construction Industry Scheme (CIS);
- the services supplied are standard or reduced rated;
- the business is not an employment business supplying either staff or workers, or both;
- the customer has not given written confirmation that they are an end user or intermediary supplier.

HMRC's newly published technical guidance provides information on how the new domestic reverse charge affects businesses, how it should be used and accounted for. It also discusses various other aspects in relation to the reverse charge including:

- the end user and intermediary supplier businesses exception;
- when to check if a customer is VAT and Construction Industry Scheme registered;
- businesses and services that are not subject to the reverse charge;
- services with reverse charge and normal VAT charging;
- changes to cash flow and monthly returns;
- change of VAT treatment during a contract.

It also contains flowcharts to help businesses decide if they need to use the reverse charge.

There are separate guides on the website directed at suppliers and purchasers of construction services.

www.gov.uk/guidance/vat-reverse-charge-technical-guide; www.gov.uk/guidance/how-to-use-the-vat-reverse-charge-if-you-buy-building-and-construction-services; www.gov.uk/guidance/how-to-use-the-vat-reverse-charge-if-you-supply-building-and-construction-services

3.4 Input tax claims on land

3.4.1 DIY claim

An unusual DIY case concerned the construction of a houseboat. The claimant obtained planning permission in 1990 and made his claim in 2019, having spent the intervening period constructing the houseboat on land before it was lowered into the water by crane. HMRC refused the claim on the basis that s.35 claims are only available where what has been constructed is "a building".

The claimant appealed, arguing that the structure had been "built"; it could not function as a boat, and was attached to the land. The fact that it floated was not enough to rule out a claim.

The judge considered that the word "building" was one that had to be interpreted in accordance with ordinary usage, which required a fixed structure, not a boat. The planning permission referred to the construction of a boat. The appellant himself had in correspondence referred to the fact that houseboats do not require a building completion certificate in the same way that a "home built in the traditional way" did. The equivalent inspection report clearly referred to the structure as a "vessel" and a "houseboat" which was "awaiting launch".

The appellant did not come within the terms of the legislation, and the appeal was dismissed.

First-Tier Tribunal (TC07766): *Edward Burrell*

3.5 Other land problems

Nothing to report.

4. INTERNATIONAL SUPPLIES

4.1 E-commerce

Nothing to report.

4.2 Where is a supply of services?

4.2.1 Abuse of international supply rules?

In 2018, the Court of Appeal decided to refer the *Newey* case back to the FTT for further consideration. This has been running for a long time, with the original facts dating from the 1990s. The case was heard in July 2019 but the decision was only released in September 2020. It remains to be seen whether this is the end.

Background

A UK-based loan broker found that his business was suffering VAT on advertising costs, while his competitors were not. On accountancy advice, he established a new structure:

- he set up a wholly-owned Jersey company (Alabaster) which obtained the appropriate credit licences and which carried on a loan broking business;
- he entered into a service agreement with his company in which he allowed it to use his trading name, and he agreed to carry on the processing of loan applications for it;
- the company entered into an agreement with a Jersey-based advertising agency to place adverts for the loan broking business in the UK.

The effect of this was that the advertising was treated as supplied outside the EU and was therefore outside the scope of UK VAT. The sub-contracted work was also a financial service supplied to a person belonging outside the EU, so it would have been outside the scope with recovery of input tax. The licensing of the trading name (for commissions of 50% and later 60% of the gross revenue on loan business written) was supplied where received under Sch.5 VATA 1994, and therefore outside the scope of VAT.

HMRC argued that the loan broking business was in reality still carried on by the UK individual, and therefore the advertising services were received by him. According to the CJEU judgment in the case, "*In practice, potential borrowers contacted directly Mr Newey's employees in the United Kingdom who processed each file and sent the applications which satisfied the credit eligibility criteria to Jersey to Alabaster's directors for authorisation. The approval process generally took around one hour to complete and, in fact, no request for authorisation was refused.*" As a result, there should be a reverse charge, which would be irrecoverable because it was being used for exempt supplies (the assessment was for more than £10m).

The FTT (2010) examined the arrangements in detail and allowed the trader's appeal, both on the question of who received the supplies and on the question of abuse of rights. Although the arrangement had been set up initially to achieve a VAT advantage, nevertheless it had been carried through properly so that the Jersey company had commercial substance and reality. The agreements were not at arm's length, but the FTT held that the parties did make the supplies that were described in them – that is, the Jersey company made supplies to UK customers, and the appellant made supplies of processing to the Jersey company. Accordingly, the advertising services were received only by the Jersey company, and there was no reverse charge.

Considering abuse of rights, the FTT did not accept that the situation was the same as in *Halifax*, where the CJEU had held that it was contrary to the purpose of the 6th Directive for an exempt business to recover input tax. This arrangement did not result in the recovery of input tax: it resulted in certain transactions being taken outside the scope of VAT. Although the effect (certainly from HMRC's point of view) might be similar, the FTT did not believe that this was contrary to the purpose of the Directive.

The FTT did consider the other aspects of the abuse issue in case it was wrong on that first question. If the arrangement was contrary to the Directive, then HMRC were justified in arguing that it had been established to achieve a tax advantage, and it would be correct to recharacterise it by regarding the business as still carried on in the UK, which would mean that the advertising services were supplied directly to the UK-based appellant. However, as the first essential feature of abuse was not proved, the appeal was allowed.

HMRC appealed to the Upper Tribunal, which decided to refer questions to the CJEU:

1. *In circumstances such as those in the present case, what weight should a national court give to contracts in determining the question of which person made a supply of services for the purposes of VAT? In particular, is the contractual position decisive in determining the VAT supply position?*
2. *In circumstances such as those in the present case, if the contractual position is not decisive, in what circumstances should a national court depart from the contractual position?*
3. *In circumstances such as those in the present case, in particular, to what extent is it relevant:*
   - *Whether the person who makes the supply as a matter of contract is under the overall control of another person?*
   - *Whether the business knowledge, commercial relationship and experience rests with a person other than that which enters into the contract?*
   - *Whether all or most of the decisive elements in the supply are performed by a person other than that which enters into the contract?*

- *Whether the commercial risk of financial and reputational loss arising from the supply rests with someone other than that which enters into the contracts?*
- *Whether the person making the supply, as a matter of contract, sub-contracts decisive elements necessary for such supply to a person controlling that first person and such sub-contracting arrangements lack certain commercial features?*

4. *In circumstances such as those in the present case, should the national court depart from the contractual analysis?*
5. *If the answer to question 4 is 'no', is the tax result of arrangements such as those in this case a tax advantage the grant of which would be contrary to the purpose of the Sixth Directive within the meaning of paragraphs 74 to 86 of the Judgment in Case C-255/02 Halifax Plc and others v CCE?*
6. *If the answer to question 5 is yes, how should arrangements such as those in the present case be recharacterised?*

The CJEU (in 2013) referred to Cases C-53/09 and C-55/09, *Loyalty Management UK* and *Baxi Group*, as authority for the importance of considering the economic and commercial realities in applying the common system of VAT. "*Given that the contractual position normally reflects the economic and commercial reality of the transactions, and in order to satisfy the requirements of legal certainty, the relevant contractual terms constitute a factor to be taken into consideration when the supplier and the recipient in a 'supply of services' ... have to be identified.*"

However, the contractual terms should not be followed if they constitute a "purely artificial arrangement" which does not correspond with the economic and commercial reality of the transactions. It is for the referring court to decide whether this is the case, but the CJEU implies that the decision could depend on whether the relationship between the owner, the Jersey company, the lenders and the advertising agency, suggested that the advertising services were in reality "used and enjoyed" by the owner in the UK, rather than by the Jersey company outside the EU.

The CJEU did not spell out who should win. It was interesting that its comment on the fifth and sixth questions was:

"*In view of the answer given to the first to fourth questions, there is no need to reply to the fifth and sixth questions referred by the referring court.*"

That suggested that the answer to question 4 should have been "yes", but no method of recharacterisation was spelled out.

CJEU (Case C-653/11): *HMRC v Paul Newey t/a Ocean Finance*

In 2015 the Upper Tribunal considered the case again, and decided that the FTT's decision could not be overturned. The UT judge considered that the FTT had concluded that the business was genuine, and had therefore effectively decided the question of "commercial and economic reality".

HMRC appealed to the Court of Appeal. Henderson LJ rehearsed the history of the dispute, the facts and the law. He noted that the UK's

leading authority on abuse of law is now the Supreme Court's 2015 decision in *Pendragon*, in which a scheme to exploit offshore transactions was held to be abusive. In that case, Lord Sumption had said:

"The selection as the funding bank of an offshore institution which was not a taxable person cannot in itself be regarded as objectionable. It is no part of the policy of the legislation that a party should be restricted in its freedom to select as its commercial partners firms whose place of residence gives dealings with them a tax advantage, even if that is the only reason for their selection. The particular method by which SGJ was brought into the chain of contracts, involving successive transactions by which Pendragon navigated its way from one VAT exemption to another, was an unnecessary and artificial way of involving them."

The judge considered other precedents, including *Weald Leasing* and *RBS Deutschland*, where the CJEU had rejected HMRC's arguments that arrangements should be recharacterised, and *University of Huddersfield*, where the Court of Appeal had agreed with HMRC.

He then turned to the detailed judgment of the CJEU. He noted that it was clear that the CJEU did not rule out the possibility that the arrangements were abusive. It was for the referring court to determine that, "by means of an analysis of all the circumstances, to ascertain whether the contractual terms do not genuinely reflect economic reality and whether it is Mr Newey, and not Alabaster, who was actually the supplier of the loan broking services and the recipient of the supplies of advertising services provided by Wallace Barnaby."

He reviewed the FTT's original decision and the UT's 2015 confirmation of it, noting that the UT judge had decided that, even if he might have disagreed with the conclusion of the FTT if he were considering the matter himself, he did not think it was appropriate for him to overturn it on a point of law.

The judge then turned to HMRC's grounds of appeal. There were four:

- that the scheme as a whole is an abuse of law, the FTT did not determine the issue on the correct basis, and the UT did not properly direct itself in accordance with the CJEU guidance;
- that the UT had decided that the scheme had to be "wholly artificial" to be an abuse, which was too high a bar;
- that the FTT had erred in law in deciding that the Jersey business did not make any exempt supplies in the UK (it made financial services supplies to lenders, which would have been supplied where received), and the UT had concluded that the FTT "could not have overlooked this";
- that the purpose of the Directive is defeated where the place of supply rules are engaged artificially in a situation in which the effective use and enjoyment of the services takes place in the EU.

The judge agreed that the UT had been too sympathetic to the FTT on the question of Alabaster's supplies. The FTT had proceeded on the assumption that Alabaster did not make any exempt supplies in the UK. According to the place of supply rules, its financial services would be "made where received", so it was clearly making exempt supplies in the UK. That was an error of law, and it entitled the UT to overturn and

remake the FTT decision. According to *Pendragon*, the UT should consider the question of abuse afresh, rather than limiting itself to considering whether the FTT had been entitled to come to the conclusions it did.

The main problem was that the FTT had considered the question of artificiality without the benefit of the CJEU judgment – which was inevitable, as the CJEU judgment followed three years after the FTT decision. The judge decided that, as a matter of judicial procedure, that was a sufficient error of law to set the FTT decision aside; in the circumstances, it would not be possible for the higher courts to remake the decision with any confidence, so it should be remitted to the FTT to reconsider the evidence in the light of the CJEU's comments. He pointed to the type of question the FTT should consider:

"Can it then make any difference to this analysis that Alabaster was incorporated on the instructions of Mr Newey, as part of a tax avoidance scheme which was designed and implemented with the sole object of relieving him from the burden of irrecoverable VAT previously borne by him as a sole trader in the UK? In my judgment this is the critical question. As A-G Maduro said in para.85 of his opinion in *Halifax*, 'the normative goal of the principle of prohibition of abuse within the VAT system is precisely that of defining the realm of choices that the common VAT rules have left open to taxable persons.' Thus it is necessary to ask whether the common system of VAT has left it open to Mr Newey to choose to restructure his business in the way that he did."

"It is in this context, as it seems to me, that the evaluation mandated by the CJEU in the present case must be performed. The CJEU cannot have meant that the threshold choice of structure should be disregarded merely because it was purely tax driven, because in that case the outcome would have been obvious, and it would not have been merely 'conceivable' that Mr Newey was still to be regarded as the supplier of the loan-broking services and the recipient of the advertising services. The CJEU must therefore have meant that the question of artificiality has to be assessed by reference to the business relationships actually entered into between Mr Newey, Alabaster, the lenders and Wallace Barnaby, with a view to testing whether they reflected underlying commercial reality. A central focus of this enquiry would naturally fall on the continued role of Mr Newey himself, and his relationship with Alabaster. Was the board of directors of Alabaster truly independent from him, or was he a shadow director with whose instructions or wishes they invariably complied? Were the loan processing functions which he and his staff continued to carry on in Staffordshire now genuinely provided to Alabaster pursuant to the Services Agreement, or was the commercial reality that Mr Newey was still carrying out the work on his own behalf? Were the advertising services provided by Wallace Barnaby to Alabaster genuinely the product of an independent commercial relationship between those two companies, or was this just elaborate machinery set up to enable Mr Newey's decisions on advertising in the UK to be implemented via his meetings with Ekay Advertising, the recommendations made by Ekay Advertising to Wallace Barnaby, and the power which he retained to approve the content of advertisements? And what is the true significance, in this context, of the fact that late advertising space offered to Alabaster was on

occasion not taken up because an Alabaster director was unavailable to approve it?"

The judge said it should be left to the FTT to decide how it wished to proceed – whether it would hear fresh evidence, or whether it had enough from the original hearing to decide the question on the new basis.

Back to the FTT

The case came before Judge Peter Kempster and Mrs Joanna Neill in July 2019 for a three-day hearing followed by further written submissions. Mrs Neill sat with Judge Berner, now retired, in the original 2010 hearing; the representatives of the taxpayer and HMRC had been the same throughout most of the litigation.

The decision proceeds in the following way:

(1) A recap of the FTT Decision, and the errors of law identified by the Court of Appeal.

(2) The guidance given by the CJEU and the domestic courts since 2010.

(3) The "findings of primary fact" from the 2010 hearing, and any supplementary findings.

(4) A reconsideration of the "evaluative findings and conclusions in the light of the further guidance now available".

(5) The error of law relating to Alabaster's exempt supplies.

(6) Conclusions and Decision.

The above summaries cover (1). The judge referred to the further decisions in this case under (2), as well as the SC judgment in *Pendragon* and the CA judgment in *University of Huddersfield*. The Tribunal did not find any reason to revisit the findings of primary fact that were set out in the first FTT decision.

Turning to the evaluative findings, the judge considered the questions referred by the UT to the CJEU, and also the questions raised by the CA in remitting the case. He came to the following conclusions:

- Alabaster was not under the overall control of Mr Newey, because he was not a director. Even though he was the sole beneficial shareholder, he did not exercise "central management and control" and played no part in its management.
- Alabaster had the business knowledge, commercial relationships and experience to carry on the loan broking business, not in itself, but by outsourcing the processing operation to Mr Newey. It was therefore capable of providing the loan broking services.
- All or most of the decisive elements in the supplies of loan broking and advertising were performed by Alabaster, not Mr Newey.
- The commercial risk of financial and reputational loss did not rest with Mr Newey.
- The sub-contracting of operations to Mr Newey did not mean that Alabaster did not carry out the supplies itself.

Turning to the questions raised by the CA, the judge commented:

- the FTT in 2010 had dealt explicitly with the question of whether Mr Newey was a shadow-director and the board of Alabaster simply a "rubber-stamping" surrogate for him, and had held that it was not.
- the FTT had also explicitly considered the question of whether the processing function carried on in Staffordshire was in reality a service provided to Alabaster, or was still effectively the loan

broking business itself, and had held that it was genuinely supplied to Alabaster.

- the FTT had also explicitly considered the question of whether the advertising was genuinely supplied by Wallace Barnaby to Alabaster, or was in reality supplied by Ekay Advertising in the UK to Mr Newey, and had decided that question in favour of Mr Newey as well.

The evaluative findings were summarised as follows:

(a) Alabaster carried on a commercial business.

(b) Alabaster was itself a commercial enterprise, carrying on economic activities of loan broking for which it equipped itself to a limited extent with its own staff and directors, and to a large extent through engaging the services of Mr Newey under the Services Agreement.

(c) Alabaster was no brass plate company.

(d) It was not in any way material to the question of commerciality that advice on the decision-making processes in Alabaster had been given by Moore Stephens.

The FTT in 2019/20 came to the same conclusions. This led to the further conclusion that the arrangements were not "a wholly artificial arrangement which does not genuinely reflect commercial reality"; the business relationships actually entered into between Mr Newey, Alabaster, the lenders and Wallace Barnaby did reflect economic and commercial reality.

The judge went on to consider the significance of the error of law in the 2010 FTT's misdescription of the supplies made by Alabaster. The judge apologised for the error, but did not consider that it affected the conclusion. The fact that Alabaster made exempt supplies in the UK could not, of itself, engage the principle of abuse of law.

As a result, the FTT confirmed that it was satisfied that the 2010 decision had been correct, even if there had been some issues with the detail: the appeal was allowed again.

First-Tier Tribunal (TC07844): *Mr Paul Newey (t/a Ocean Finance)*

4.2.2 Place of supply: data hosting

A Finnish company provided data hosting services to telecoms operators in Finland. The company housed its customers' servers in premises equipped with the necessary electronic connections, in which humidity and heat are precisely regulated to allow use of these servers according to their intended purpose in a refrigerated environment.

The servers are housed in "patch bays", which are screwed to the floor and provide the various services necessary for servers to be installed in them; the servers can be detached from a patch bay in minutes. The company controlled access to a customer's patch bay, but did not itself have the right to access it.

In response to a ruling request, the tax authority decided that the applicable place of supply rules were those relating to immovable property and were therefore subject to tax where the building was

situated. A Finnish court overturned this, holding that the patch bays were not "immovable", and holding that the supply was subject to the general rule for services. There was a basket of services, the main one of which was offering the best possible environment for the operation of the customer's servers. The Supreme Court of Finland referred questions to the CJEU.

The court noted that the referring court had proceeded on the assumption that there was a main service with ancillary and incidental elements (such as the provision of electricity), and the court would give its answer on that basis.

The court went on to reformulate the question, considering that the issue went beyond place of supply (art.13 and 31 Implementing Regulation) and extended to the application of the exemption in art.135(1)(l) PVD. In that context, the court considered that the service provided was not the normal passive provision of rights over land; the customer would not have the right to control access to any part of the building "as if the owner".

The patch bays did not appear to be "integral parts of the building" within IR art.13, and were not "permanently installed". They therefore did not appear to be immovable property capable of falling within the exemption.

The court went on to consider whether art.47 PVD applied. The list in that article was not exhaustive, and there was no presumption or precedence between the general rules on place of supply and the special rules. However, to fall within art.47, a service must relate to a particular immovable property and must have as its object the building itself. The Implementing Regulation articles 31a and 31b are based on this principle: either immovable property is an element constitutive of the service and is central and essential for the services provided, or, on the other hand, the services are provided or intended for immovable property and are intended to modify the legal status or the physical characteristics of the property.

The restrictions on the customers' access, the fact that they cannot control other people's access, and the classification of the patch bays as not immovable property all counted against the application of art.47. The provision of the data hosting centre was therefore a standard rule service.

CJEU (Case C-215/19): *Veronsaajien oikeudenvalvontayksikkö*

4.2.3 Article

In an article in *Taxation*, Mike Thexton examines the rules on place of supply of services (following up from a previous article about place of supply of goods).

Taxation, 16 July 2020

4.3 International supplies of goods

4.3.1 Brexit – general

Not surprisingly, with the end of the transitional period approaching, there has been an acceleration in the material being published on arrangements for buying and selling goods between the UK and the EU after 31 December 2020. However, the arrangements have not been finally agreed, and it seems inevitable that there will be many people who are not prepared for the new rules – whatever they turn out to be – on the first day.

The government announced a new Border Operating Model on 13 July 2020, setting out plans for customs controls and regulations to be phased in for the movement of goods between Great Britain (GB) and the EU from 1 January 2021. To afford industry extra time to make necessary arrangements, the UK Government has taken the decision to introduce the new border controls in three stages up until 1 July 2021. As the document is 262 pages long, covering a wide variety of different aspects, six months may be too short.

www.gov.uk/government/publications/the-border-operating-model

The combination of Covid and Brexit is reflected in some of the relaxations proposed. For example, from 1 January 2021 to 30 June 2021, goods with pre-lodged temporary storage declarations may be imported through border locations in Great Britain (England, Scotland and Wales) outside existing customs control systems, and transported to a temporary storage facility in Great Britain provided they meet the requirements set out in published guidance.

www.gov.uk/guidance/movements-to-temporary-storage-facilities-from-1-january-2021-to-30-june-2021

On 2 July, the Ministry of Justice published a consultation on the retention of EU case law and the extent to which UK courts and Tribunals will have the authority to depart from CJEU precedents. The CIOT submitted a detailed response discussing many of the issues arising.

www.gov.uk/government/consultations/departure-from-retained-eu-case-law-by-uk-courts-and-tribunals; www.tax.org.uk/policy-technical/submissions/retained-eu-case-law

The CIOT has responded to this consultation. The main points of the response are:

- The CIOT agrees that the power to depart from retained EU case law should be extended to other courts and tribunals beyond the UK Supreme Court and High Court of Justiciary in order to provide access to justice, and distribute the burdens on the courts across a wider base;
- The CIOT suggests that option 1 (Court of Appeal), with a right to leap frog from lower courts to the Court of Appeal in appropriate circumstances, would provide the optimum outcome in that it would achieve the best balance of enabling timely departure from retained EU case law whilst maintaining legal certainty across the UK;

- The CIOT does not think that enabling the courts and tribunals to depart from retained domestic case law relating to retained EU case law would be helpful. The policy decisions as to why the existing UK system of precedent should be changed with respect to retained EU case law is not clear.

www.tax.org.uk/policy-technical/submissions/retained-eu-case-law

HMRC have sent letters to VAT-registered businesses in Great Britain identified as trading with the EU and/or the rest of the world, highlighting actions they need to take to continue trading with the EU from 1 January 2021.

While the import processes and customs declarations for non-controlled goods can be delayed until 30 June 2021, the UK will operate a full external border with the EU when importing and exporting goods that are categorised as 'controlled' from the beginning of 2021.

The recommended measures include:

- making sure they have a UK Economic Operator Registration and Identification (EORI) number;
- deciding how they will make customs declarations;
- checking if their imported goods are eligible for staged import controls;
- checking if import VAT is due at the border;
- deciding how they will account for import VAT when they make a customs declaration;
- checking the UK global tariff list;
- signing up for the new Trader Support Service, if they move goods between GB and Northern Ireland (NI), or bring goods into NI from outside the UK (see below).

www.gov.uk/government/publications/letters-to-businesses-about-new-trade-arrangements-with-the-eu-from-1-january-2021

4.3.2 Northern Ireland

On 31 July, the Commission proposed changes to the EU's VAT rules to accommodate trade with Northern Ireland in preparation for Brexit completion day. The changes would 'introduce a special identification number for businesses in Northern Ireland, so that EU VAT provisions can be properly applied to goods, in line with the Protocol on Ireland/Northern Ireland'. The provisions would not apply to supplies of services in Northern Ireland, which will instead be subject to UK VAT rules after 31 December. The Commission has encouraged Member States to 'rapidly agree to the proposal, so that it can be implemented as quickly as possible' in time for 1 January 2021.

ec.europa.eu/taxation_customs/news/commission-proposes-amend-vat-rules-accommodate-trade-northern-ireland-after-transition-period_en

The United Kingdom Internal Market Bill was introduced to the House of Commons on 9 September 2020. The proposals in relation to movement of goods between the UK and Northern Ireland caused an immediate

storm both in the UK and in the EU, because of the threat to override elements of the withdrawal agreement in order to ensure "unfettered access" to the UK market for NI goods. This has not yet been resolved.

The response included correspondence between Parliament's European Union Committee and government ministers seeking clarification.

https://committees.parliament.uk/committee/176/european-union-committee/publications/3/correspondence/

The Trader Support Service, which is intended to guide traders who move goods between GB and NI, has now gone live, and affected traders are invited to sign up.

www.gov.uk/guidance/moving-goods-into-out-of-or-through-northern-ireland-from-1-january-2021; www.gov.uk/guidance/trader-support-service

HMRC have published letters sent to VAT-registered businesses in Northern Ireland highlighting actions they need to take in order to prepare for the end of the transition period. Further new and updated guidance may be issued depending on the precise terms upon which the UK leaves the EU, so stakeholders are advised to monitor these pages for updates. HMRC has published different versions of the letters for traders who trade with the EU and rest of the world, and traders who do not.

www.gov.uk/government/publications/letters-to-businesses-in-northern-ireland-about-new-processes-for-moving-goods-from-1-january-2021

In an article in *Taxation*, Kevin Hall speculates whether mainland UK businesses could benefit from a connection with Northern Ireland following the end of the transition period, if the VAT advantages of the unique "dual" status of NI remain as they appear now. However, that is subject to the final negotiations between the UK and the EU.

Taxation, 1 October 2020

4.3.3 UK goods sold to overseas customers

The Treasury has announced an end to the VAT retail export scheme and VAT-free sales of goods in airports with effect from the end of the Brexit implementation period. The VAT retail export scheme — which broadly allows overseas visitors in British shops to claim VAT refunds on items taken home in luggage — is set to end from 1 January 2021 according to a press release from the Treasury. The Treasury describes this as a 'costly system' but says that overseas visitors may still buy items VAT-free in stores and have these sent direct to their overseas addresses. This change is set to take place in England, Wales and Scotland. In addition, the Treasury has suggested that it will be ending tax-free sales in airports of goods such as electronics and clothing for passengers travelling to non-EU countries.

www.gov.uk/government/news/duty-free-extended-to-the-eu-from-january-2021

In the meantime, the VAT *Personal Exports Retail Exports Manual* has been updated with added guidance on export control procedures and appeals of decisions to reject forms.

VATRES4150

4.3.4 Bulk imports

HMRC have published a new policy paper and statutory guidance in relation to the *Customs (Bulk Customs Declaration and Miscellaneous Amendments) (EU Exit) Regulations 2020*, together with draft text for a number of Notices that will be issued under these regulations. Parcel operators that import low value goods into Great Britain, businesses that use duty deferment and freight forwarders or businesses importing goods via Eurotunnel are likely to be affected by these measures.

www.gov.uk/government/publications/uk-transition-the-customs-bulk-customs-declaration-and-miscellaneous-amendments-eu-exit-regulations-2020; www.gov.uk/government/publications/draft-notices-to-be-made-under-the-customs-bulk-customs-declaration-and-miscellaneous-amendments-eu-exit-regulations-2020

HMRC have also published new guidance on how to apply to become authorised to make bulk declarations for low value parcel imports and points to consider before and after making an application.

www.gov.uk/guidance/apply-to-import-multiple-low-value-parcels-on-one-declaration-from-1-january-2021

4.3.5 Overseas goods sold to UK customers

At the end of the transition period, the government will introduce a new model for the VAT treatment of goods arriving into Great Britain from outside of the UK. This will ensure that goods from EU and non-EU countries are treated in the same way and that UK businesses are not disadvantaged by competition from VAT-free imports. It also aims to improve the effectiveness of VAT collection on imported goods and address the problem of overseas sellers failing to pay the right amount of VAT on sales of goods that are already in the UK at the point of sale.

This policy paper follows publication on 13 July 2020 of *The Border Operating Model*, and expands on the sections of that document covering the VAT treatment of consignments not exceeding £135 from 1 January 2021. It also includes information on the abolition of Low Value Consignment Relief, the implications for online marketplaces, and various other new arrangements that will apply from 1 January 2021.

www.gov.uk/government/publications/changes-to-vat-treatment-of-overseas-goods-sold-to-customers-from-1-january-2021

4.3.6 Customs guarantees

HMRC have published new guidance on customs comprehensive guarantees, and how to get a guarantor. It also provides information on which process to use if a business's customs comprehensive guarantee covers a duty deferment account, special procedures or temporary storage, and Union and Common Transit.

www.gov.uk/guidance/get-a-guarantor-for-your-customs-comprehensive-guarantee

4.3.7 Customs warehouses

HMRC has updated its guidance on payment of customs duty and import VAT when goods are removed from a customs warehouse to free circulation. The guidance has been updated to explain how the value of goods is determined where there has been a sale for export to the UK or EU before the goods enter a customs warehouse. In such cases, the value of the goods is based on that sale. If there has been no sale for export, the seller can make a sale within the customs warehouse regime using the duty and exchange rates at the time of removal from the warehouse. When a seller releases goods to free circulation, they may be entitled to claim a reduced or zero duty rate under a 'tariff preference' or a 'tariff quota' or the goods may qualify for relief from customs duty or import VAT.

www.gov.uk/guidance/how-to-use-a-customs-warehouse

4.3.8 New paperwork for imports and exports

HMRC have published new guidance for UK VAT-registered businesses using postponed VAT accounting for import VAT after 31 December 2020. Traders do not need to be authorised to account for import VAT on the VAT return and can start doing so from 1 January 2021. They can use the return to account for import VAT if:

- the imported goods are for use in the business;
- the trader includes the GB EORI number on the customs declaration;
- the trader includes the VAT registration number on the customs declaration, where needed.

If the trader initially declares goods into a customs special procedure, it will still be possible to account for import VAT on the VAT return on submission of the declaration that releases those goods into free circulation from the following special procedures:

- customs warehousing;
- inward processing;
- temporary admission;
- end use;
- outward processing;
- duty suspension.

Traders can account for import VAT on the VAT return when they release excise goods for use in the UK ('released for home consumption'). This includes when goods are released from an excise warehouse after being in duty suspension since the point of import.

Traders will not be able to account for import VAT on the VAT return if they are authorised to use simplified declarations for imports and they complete their simplified frontier declaration before 1 January 2021 (or even if they complete it after that date).

www.gov.uk/guidance/check-when-you-can-account-for-import-vat-on-your-vat-return; www.gov.uk/guidance/complete-your-vat-return-to-account-for-import-vat

In preparation for Brexit, HMRC have published new guidance on importing goods into the UK from the EU from 1 January 2021. When importing standard goods into the UK between 1 January and 30 June 2021, businesses will be allowed to use 'entry in the declarant's records' without getting authorisation in advance. They need not submit an entry summary declaration but record the goods in their own records. A supplementary declaration will then have to be made within six months of importing the goods. HMRC's existing guidance has also been updated to reflect this change.

www.gov.uk/guidance/declaring-goods-brought-into-great-britain-from-the-eu-from-1-january-2021

HMRC have published guidance regarding the import and export of goods between Great Britain and the EU from 1 January 2021. The two separate documents provided by HMRC will help traders prepare for the changes

following the end of the transition period on 31 December 2020 and outline a step by step process for completing customs declarations.

www.gov.uk/government/publications/how-to-import-and-export-goods-between-great-britain-and-the-eu-from-1-january-2021

HMRC have published new guidance on the Exit Summary declaration process. Traders who move goods outside the UK or EU, need to make an Exit Summary declaration if the goods are not covered by a full export declaration and contain safety and security data. This will apply, for example, when:

- an empty container is being returned under a transport contract to the shipper;
- goods have remained in temporary storage for more than 14 days;
- goods have remained in temporary storage for less than 14 days but the import safety and security declaration details are unknown or where the destination or consignee change;
- goods are moving between two member states but the goods are routed to travel through a third country.

Traders must present their EXS declaration to customs before the goods are exported. The time limits for submission vary depending on the type of transport or shipping service used.

www.gov.uk/guidance/find-out-when-to-make-an-exit-summary-declaration

HMRC have published guidance on the Import Control System, including registering in order to make entry declarations.

www.gov.uk/guidance/register-to-make-an-entry-summary-declaration

HMRC have published information about the selection of imported goods for pre-clearance checks. This states that goods selected for checking will be moved to an inland location, and may not be cleared for up to 5 weeks.

www.gov.uk/guidance/when-we-select-your-goods-for-inland-pre-clearance-checks

4.3.9 Failed despatch

A Northern Ireland trader zero-rated some supplies of stone on the basis that they had been supplied to a customer with a valid Republic of Ireland VAT number. HMRC disputed this and raised an assessment. Following the hearing of the appeal on this issue, the appellant made a written submission accepting that the goods had been used to construct a house in the UK, but arguing that he should still be allowed to zero-rate the supply on other grounds, including avoiding the unjust enrichment of HMRC.

The disputed invoices related to supplies made on 11 successive invoices to the same customer (apparently stage payments for a large contract) in 2014 and 2015. The RoI VAT number did not belong to the named customer, and had been deactivated by the RoI authorities with effect from 31 August 2013. The trader argued that the length of time taken to quarry, prepare and supply the goods was such that the number was valid when the contract was agreed, and he had made appropriate checks at that

time. He claimed that he had checked the VAT number on the Europa website on 11 April 2014 and it had shown as valid.

HMRC accepted in 2017 that the RoI decision to deregister had only been taken on 10 April 2014 and backdated to August 2013, so the first two invoices (raised in February and March 2014) would be excluded from liability. A revised assessment was issued covering the remaining 9 invoices.

HMRC contended that the fact the goods had not left the UK meant that the zero-rating of despatches could not be justified, regardless of the RoI VAT number. The appellant tried to argue that the bespoke nature of his business meant that he was supplying a service, rather than goods, or that the fact that the customer could have recovered the VAT under the DIY builders' scheme should be taken into account.

The Tribunal was satisfied that, as a matter of law, the trader was not permitted to zero-rate the supplies. The judge went on to consider whether he would have to account for the output tax. He relied on para.4.10 of Notice 725, claiming to have done "everything he could to check the validity of the VAT number" and "had no other reason to suspect the VAT number was invalid". The judge rejected this. There was no evidence other than his own statement that he had done any checking at all. It seemed that he was aware that the customer was building his own house, so the use of a VAT number on the invoice should have raised questions. He himself said he had visited the building site, so he should have been aware that it was in the UK, even if the border is hard to identify in parts of Northern Ireland.

For all these reasons, the Tribunal considered the witness evidence to be unreliable, and on the balance of probabilities found that he did not check the VAT number. Even if he had, that would not have been enough, because there was no evidence of despatch. There was no merit in the argument that the supply was of construction services, nor in the reliance on the DIY builders' scheme. That required a charge by the supplier and a claim by the builder, and these were necessary to make sure that all the conditions of the scheme were satisfied.

The appeal was dismissed.

First-Tier Tribunal (TC07736): *Roy Reaney t/a Armagh Marble*

4.3.10 Travellers' luggage

Art.147 PVD provides a VAT exemption for "goods to be carried in the personal luggage of travellers", subject to a number of conditions. These include the transportation out of the EU within 3 months of the supply taking place, and the traveller not being established in the EU. Member States may impose a minimum value for the relief of €175, but there is no upper limit.

This relief is given effect in the UK as the "retail export scheme". People who are eligible to claim the exemption generally have to pay the VAT to a retailer on purchase of goods, but they are given paperwork to present to Customs at the point of exit. Customs then authorise the retailer to treat the sale as a zero-rated export ("exempt", in EU terms) and reclaim the output tax charged. It is then supposed to be refunded to the traveller.

Agencies at airports may give travellers the cash upfront and will take over pursuing the retailer.

A Hungarian business entered into transactions with 20 Serbian individuals belonging to 3 families. The goods were transported to a warehouse rented by the customers in Hungary close to the Serbian border. The goods were then presented as “retail exports” on exit from the EU. The business operated the retail export scheme as described above.

It was clear that the goods were being purchased to be sold in Serbia, and the Hungarian trader knew this. The value of each supply was kept below a set level to avoid problems with Hungarian customs procedures.

The tax authority carried out an inspection and concluded that the goods were not “travellers’ luggage”, because they were for commercial purposes. It also ruled that no other exemption applied, so output tax was due, plus a late payment surcharge and a fine.

The national court dismissed an appeal, agreeing with the tax authority that the quantity of goods and the frequency of purchases were relevant in determine what was “travellers’ luggage”. As there was nothing in the PVD to define it, the concept was open to reasonable interpretation by the Member State; according to national practice, traveller’s luggage was to be regarded as the goods which a traveller purchases for his own personal needs or as a gift, and must under no circumstances be for commercial purposes.

The company did not qualify for exemption of commercial exports (art.146) because it had not followed export procedures and had not cleared the goods as exports; the customers had expressly asked to use the exemption for travellers’ luggage.

The company appealed, and questions were referred to the CJEU to clarify the concept of “travellers’ luggage”, and also to determine whether exemption under art.146 necessarily followed from disallowing exemption under art.147 on the grounds that the goods were commercial, in spite of the customer’s preference for the art.147 procedure. The final question asked whether the alleged “bad faith” of the Hungarian business, in applying the art.147 procedure to goods it knew were commercial, justified the withholding of tax refunds that were incorrectly claimed.

Advocate-General Sanchez-Bordona has given an opinion that is restricted to the interpretation of “travellers’ luggage”. It appears that the CJEU directed him to consider only those questions, although it is not clear why.

The principle of interpreting exemptions requires that the meaning and scope of terms for which EU law provides no definition must be determined by reference to their usual meaning in everyday language. However, account must also be taken of the context in which the terms occur, and the purposes of the rules in question. The Hungarian rule appeared to consider only the everyday meaning, and was therefore not in accordance with the case law.

The A-G went on to examine the context and purposes of the exemption, to decide whether it could be extended to commercial items that were transported by a traveller (i.e. the expression related to the way in which the goods were exported, rather than implying “personal effects”). He

considered the history of the exemptions for personal imports and exports going back to the 1960s, and concluded that they had consistently been intended only to apply to non-commercial items. This would mean that the exports should be occasional and for personal or family use or intended as presents. The nature or quantity of the goods must not be such as to indicate they were being exported for commercial reasons.

The A-G recommended that the CJEU answers the first two questions referred by stating that the context and purpose of the provisions had to be considered as well as the everyday meaning of the terms; that the 1954 New York Convention concerning Customs Facilities for Touring and various other EU regulations did not provide that context, because they did not apply; but that nevertheless the exemption should only apply to items of a non-commercial character.

The other questions (whether art.146 could apply instead, and whether "bad faith" was relevant) were not considered.

CJEU (A-G) (Case C-656/19): *Bakati Plus Kereskedelmi és Szolgáltató Kft. v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága*

4.3.11 Distance selling

A company established in Poland had no office or warehouse in Hungary; the Hungarian tax authorities accepted that it did not have "another fixed establishment" in the country. It marketed products for animals through a website, which had a Hungarian address, and had a number of online customers. During 2012, the website offered the possibility for purchasers to contract with a transport company established in Poland for delivery of the goods, without the supplier being a party to that contract. Purchasers could also choose a carrier other than the recommended one. The supplier used the recommended transport company for some of its own logistical needs. Where the customer used the transport company, it delivered the goods to the warehouses of two courier companies established in Hungary, which delivered them to the customers.

The Polish company asked the Polish authorities for a ruling on where its transactions were subject to VAT, and the Polish authorities confirmed that it was Poland. The Hungarian tax authorities then carried out an inspection and registered the company for distance sales in Hungary from 2012 onwards, charging a penalty and default interest as well as VAT. The company appealed, and questions were referred to the CJEU on the distance selling rules in art.33 PVD, in particular the meaning of the expression "dispatched or transported by or on behalf of the supplier".

The court also asked for clarification of the ability of the Hungarian tax authorities to take a different position from that taken by the Polish authorities, in the light of the principles of fiscal neutrality and the avoidance of double taxation; and whether, if it was effective in retaining a Polish place of supply, the company's arrangements amounted to an abuse of rights.

The first three questions referred were summarised by the court as asking whether the tax authorities of one Member State could unilaterally subject transactions to a VAT treatment different from that under which they have already been taxed in another Member State. The court referred to Regulation 904/2010 on administrative cooperation and combating fraud

in the field of VAT. It lays down conditions under which the authorities are supposed to cooperate with each other and with the Commission, and the objectives of doing so. The regulation was concerned with the exchange of information, but did not require different tax authorities to cooperate in order to reach a common solution in respect of the proper tax treatment of transactions, nor require that the authorities in one state were bound by a decision taken by the authorities in another state.

The problem of double taxation should be resolved by a reference to the CJEU. If it was found that one state had taxed a transaction that should be taxed in another state, the correct solution was for the first state to refund the overpaid VAT, and the proper tax to be paid in the other state. There was nothing in the directives or regulations that required the incorrect charge to be maintained merely for the prevention of double taxation.

The court went on to consider whether the arrangements put in place took the transactions outside the distance selling provisions. An amendment has been made to the rules, to take effect from 1 January 2021, to clarify that they apply where "the supplier intervenes indirectly in the transport or dispatch of the goods." This therefore appears to catch the arrangements made in 2012, but the need for clarification might imply that the arrangements should work up to the end of 2020.

The expression "by or on behalf of the supplier" should be interpreted according to the commercial and economic realities of the situation. The Advocate-General's opinion was that goods are dispatched or transported on behalf of the supplier if it is the supplier, rather than the customer, that effectively takes the decisions governing how those goods are to be dispatched or transported. This would apply where the role of the supplier is predominant in terms of initiating and organising the essential stages of the dispatch or transport of the goods.

It would be for the referring court to determine whether the transport supply was "really" received by the customer, in accordance with the contract, or by the supplier, in accordance with commercial and economic reality. This was the same consideration as applied in the *Newey* case. Part of that reality was the active offering of goods to purchasers residing in a different country and "the organisation by that supplier of the means enabling the goods concerned to be delivered to their purchasers [as] an essential part of that activity". The fact that the Polish country operated a Hungarian website (with a .hu suffix) in the Hungarian language could be taken into account.

The mere fact that the supplier also used the recommended transport company for its other activities could not be relevant; however, if the customers simply acquiesced to the choices made by the supplier, that would suggest that the distance selling rules applied. This might be inferred if the contracts relating to the dispatch or transport of those goods may be concluded directly from that supplier's website without the purchasers having to take independent steps to contact the companies responsible for that delivery.

The burden of risk during transport was also relevant. The appellant argued that this fell on the transport company, according to the contracts concluded between it and the customers; the court ruled that this was not conclusive, if the supplier in fact ultimately bears the costs relating to compensation for damage occurring during dispatch or transport.

Lastly, the payment arrangements were also significant. If the separate contracts were the subject of a single payment by the customer, that might indicate that the supplier was taking a predominant role in the transport.

The court considered the question of abuse of rights, and concluded that there was nothing in the order for reference that suggested that the companies were engaged in anything other than genuine economic activity. In short, if the referring court decided that the transactions met the conditions to fall outside the distance selling rules, then they were genuine, and the arrangement was successful in charging the supplies at the lower rate of Polish VAT; if the referring court took the opposite view, there was no need for a finding of abuse of rights.

CJEU (Case C-276/18): *KrakVet Marek Batko sp.k. v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága*

4.3.12 Import reliefs

HMRC have published a series of guides on claiming reliefs to pay no customs duty or import VAT in a variety of circumstances:

- importing decorations/awards;

www.gov.uk/guidance/pay-no-import-duty-and-vat-when-importing-decorations-and-awards

- goods for charity;

www.gov.uk/guidance/pay-no-import-duties-and-vat-on-goods-for-charity

- goods temporarily imported (Temporary Admission);

www.gov.uk/guidance/check-if-you-can-get-import-duty-relief-on-goods-using-temporary-admission

- goods for disabled people;

www.gov.uk/guidance/pay-no-customs-duty-or-vat-on-goods-for-disabled-people

- commercial samples;

www.gov.uk/guidance/pay-no-import-duty-and-vat-on-importing-commercial-samples

- goods for testing.

www.gov.uk/guidance/pay-no-import-duties-or-vat-on-importing-goods-for-testing

- scientific instruments and apparatus for education or research.

www.gov.uk/guidance/pay-no-customs-duty-and-vat-on-scientific-instruments

HMRC have also published guidance on the use of customs special procedures to reduce the customs duty and VAT paid in a number of circumstances:

- goods exported for repair, maintenance and processing and then re-imported (using Outward Processing Relief);

www.gov.uk/guidance/using-outward-processing-to-process-or-repair-your-goods

- goods imported for specific uses such as repairs, maintenance and processing (using End-use Relief);

www.gov.uk/guidance/apply-to-pay-less-duty-on-goods-you-import-for-specific-uses

- goods re-imported to the UK and EU (Returned Goods Relief);

www.gov.uk/guidance/pay-less-import-duty-and-vat-when-re-importing-goods-to-the-uk-and-eu

- goods stored, temporarily used, processed or repaired (using various special procedures).

www.gov.uk/guidance/pay-less-or-no-duty-on-goods-you-store-process-repair-or-temporarily-use

4.3.13 Medical imports

In light of the pandemic, the period for claiming relief from import duty and VAT on medical supplies, equipment and protective garments was extended for another three months from the intended end date of 31 July. It now applies to imports into the UK from 30 January 2020 until 31 October 2020.

www.gov.uk/guidance/pay-no-import-duty-and-vat-on-medical-supplies-equipment-and-protective-garments-covid-19

4.4 European rules

4.4.1 E-commerce rules

On 30 September 2020, the Commission published Explanatory Notes on the new VAT e-commerce rules. They contain extensive explanations and clarifications on these new rules including practical examples on how to apply the rules if you are a supplier or an electronic interface (e.g. marketplace, platform) involved in e-commerce transactions. These explanatory notes are meant to help online businesses and in particular SMEs to understand their VAT obligations arising from cross-border supplies to consumers in the EU. The introduction to the document provides a useful summary, and is reproduced below.

Overview of the package

The VAT e-commerce package will facilitate cross-border trade, combat VAT fraud and ensure fair competition for EU businesses. The new rules include:

- Improvements of the current MOSS
- Special provisions applicable to supplies of goods facilitated by electronic interfaces
- Extension of the scope of the MOSS, turning it into a One Stop Shop (OSS), to:
  - B2C supplies of services other than TBE services
  - Intra-EU distance sales of goods
  - Certain domestic supplies of goods facilitated by electronic interfaces

- Distance sales of goods imported from third countries and third territories in consignments of an intrinsic value of maximum EUR 150

The VAT e-commerce package and implementation calendar

The VAT e-commerce package will be implemented gradually. Below is an overview of the key-dates:

In 2019

(see details on the MOSS portal)

Introduction of two thresholds to simplify VAT obligations for microbusinesses and SMEs. First, an annual turnover threshold of €10,000 for intra-EU cross-border supplies of telecommunications, broadcasting and electronic (TBE) services. Up to €10,000 TBE supplies remain subject to the VAT rules of the Member State of the supplier. Second, an annual turnover threshold of €100,000 up to which the vendor must only keep one piece of evidence (instead of two) to identify the Member State of the customer.

For invoicing, the rules of the EU country of identification of the supplier will be applicable instead of the rules of the Member States of consumption (i.e. of the customer).

Close a gap in the current MOSS: a business not established in the EU but having a VAT registration in the EU (e.g. for occasional transactions) can make use of the non-Union scheme (i.e. the scheme for taxable persons not established in the EU).

Some improvements of the current MOSS enter into force on 1 January 2019, in particular those not having any IT impact.

In 2021

The extension of the MOSS and the special provisions concerning the obligations of electronic interfaces will enter into force on 1 July 2021 as IT systems need to be adapted or developed.

- Businesses operating electronic interfaces such as marketplaces or platforms will, in certain situations, be deemed for VAT purposes to be the supplier of goods sold to customers in the EU by companies using the marketplace or platform. Consequently, they will have to collect and pay the VAT on these sales.
- Building on the success of the MOSS for TBE services, this concept will be extended and turned into a OSS:
  - The non-Union scheme for supplies of TBE services by taxable persons not established in the EU will be extended to all types of cross-border services to final consumers in the EU;
  - The Union scheme for intra-EU supplies of TBE services will be extended to all types of B2C services as well as to intra-EU distance sales of goods and certain domestic supplies facilitated by electronic interfaces. The extension to intra-EU distance sales of goods goes hand in hand with the abolition of the current distance sales threshold, in line with the commitment to apply the destination principle for VAT;

- An import scheme will be created covering distance sales of goods imported from third countries or territories to customers in the EU up to a value of €150.

Unlike today, when the import scheme is used, the seller will charge and collect the VAT at the point of sale to EU customers and declare and pay that VAT globally to the Member State of identification in the OSS. These goods will then benefit from a VAT exemption upon importation, allowing a fast release at customs.

The introduction of the import scheme goes hand in hand with the abolition of the current VAT exemption for goods in small consignment of a value of up to €22. This is also in line with the commitment to apply the destination principle for VAT.

Where the import OSS is not used, a second simplification mechanism will be available for imports. Import VAT will be collected from customers by the customs declarant (e.g. postal operator, courier firm, customs agents) which will pay it to the customs authorities via a monthly payment.

Who will benefit from this proposal?

- Businesses will benefit from a substantial reduction in cross-border VAT compliance costs. This will facilitate greater cross-border trade.
- EU Businesses will be able to compete on equal footing with non-EU businesses that are not charging VAT.
- Member States will gain through an increase in VAT revenues of €7 billion annually.

https://ec.europa.eu/taxation_customs/business/vat/modernising-vat-cross-border-ecommerce_en

4.4.2 Pandemic imports

On 23 July the Commission published a decision extending relief from import duties and VAT exemption on importation granted for goods to combat coronavirus (COVID-19). The relief had been intended to apply until 31 July, but was extended to 31 October. The measure covers masks and protective equipment, as well as testing kits, ventilators and other medical equipment.

Commission Decision (EU) 2020/1101

4.4.3 MTIC fraud investigation

Europol has announced that an international law enforcement operation involving five countries has led to the arrest of two ring-leaders of an organised crime group in Hungary which caused a tax loss of £3.4 billion forints (about €9.7 million).

Around 33 properties belonging to the crime group in Hungary, Austria, Czechia, Slovakia and Serbia were searched. Europol assisted the Hungarian National Tax and Customs Administration, the Czech Police, the Serbian Anti-Corruption Department, the Austrian Tax investigation office, the Austrian State Police and the Slovak Police in the investigation. The crime group used ‘sophisticated infrastructure’ to evade tax by

purchasing food products with high demand from Croatian manufacturers and moving the products to Hungary without paying VAT, allowing them to achieve a 27% margin rate.

www.europol.europa.eu/newsroom/news/vat-scammers-arrested-in-hungary-after-evading-close-to-€10-million-in-tax

4.4.4 OECD reviews VAT

The Organisation for Economic Co-operation and Development (OECD) has published taxation working paper No. 49 on ‘Reassessing the regressivity of the VAT’. This is an economic study based on examination of the systems in 27 OECD countries, assessing the effect of VAT on poorer households. VAT is considered to be a “regressive” tax, in that it impacts more heavily on those on low incomes. The OECD recommends consideration of a progressive tax-benefit system in order to compensate poor households for the loss in purchasing power from paying VAT.

www.oecd-ilibrary.org/taxation/reassessing-the-regressivity-of-the-vat_b76ced82-en

4.4.5 Covid delays

Various changes to rules, that were due to come into force on 1 January 2021, have been deferred to 1 July 2021 by the Commission. The details are contained in Implementing Regulation (EU) 2020/1318 published on 23 September.

https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32020R1318

4.4.6 Unusual land transactions

A holder of a “perpetual usufruct” used some land as if they were the owner, while the “formal owner” had the legal title under civil law. Fees paid by the holder of the usufruct to the owner were subject to Polish VAT. As part of a reform of the law on property, the previous owners of the land have now, by operation of law, lost their ownership to the holders of the right of perpetual usufruct. The latter are required to continue to pay annual instalments for perpetual usufruct for 20 years or to make a one-off payment in the same amount. The question of whether the payments required by operation of law were VATable was referred to the CJEU, and A-G Kokott has given an opinion. A further complication was that the land was owned by a public authority, so the question of the capacity of the owner as a taxable person also arose.

The property law reform had the effect that ownership changed hands on 1 January 2019. The perpetual usufructuaries became the legal owners; they were required to pay an annual sum for 20 years, identical to the previous usufruct payments, or else to pay a one-off sum.

The Polish law specifically provided that the transfer of land by a public authority by operation of law, and the leasing of land by perpetual usufruct, were both supplies of goods. The municipality of Wroclaw applied for a tax ruling, and the tax authority confirmed that the transactions would be subject to VAT in the same way as the previous annual payments.

The A-G commented that the referring court had framed the questions only in terms of a supply of goods. She pointed out that VAT liability could also arise if the transaction constituted a supply of services. In her view, whether the "transformation of ownership" was regarded as a transaction separate from the previous usufruct, or whether an economic overview was taken (in which case the situation afterwards was very similar to the situation before, at least for 20 years), there was a taxable supply. It was either a supply of goods or, if it was not, it had to be a supply of services. Although the payment arose as a result of the operation of law, nevertheless it met the conditions for a supply for consideration – there was a legal relationship between the parties and reciprocal performance. The usufructuary obtained a benefit in return for the payment – as legal owner, it would be able to transfer the land to others.

The A-G preferred the "economic overview" approach, in which case the payments after the transformation were simply a continuation of the supply of goods that existed beforehand. If the parties agreed to make a one-off payment instead of making annual payments, that only changed the timing of the consideration, not the nature of the supply.

She went on to consider the relationship between art.14(1) and art.14(2) PVD, and concluded that it was not particularly relevant in the context: there was in either case a taxable supply.

Turning to the question of whether the municipality was acting as a taxable person, the A-G noted that the property law reform might be directed mainly, or possibly even exclusively, at land owned by public authorities. Nevertheless, the capacity in which the authority owned the land and received these payments was not within the special legal regime applicable to public authorities, but rather in its capacity as the previous owner of the land. The previous payments had been VATable, and so were the transformation payments.

CJEU (A-G) (Case C-604/19): *Gmina Wrocław v Dyrektor Krajowej Informacji Skarbowej*

4.4.7 Heat and rent

An association of property owners supplied heat to those property owners and claimed input VAT on expenditure associated with that activity. The German tax authority rejected that claim. It held that, pursuant to German law, the supply of heat to property owners is exempt from VAT. Questions were referred to the CJEU.

The association comprises three legal persons (a private company, a public authority and a municipality), and the property ('the estate') consists of 20 rental apartments, a department of the public authority, and an entity of the municipality. In 2012, the applicant constructed a combined heat and power unit ('the CHPU') on the estate. It started generating electricity from the CHPU. It then sold the electricity to a power company, and supplied the heat produced thereby to the owners. The tax authority restricted an input tax claim on the costs of the installation to 28%, representing the proportion used in generating electricity. The authority ruled that the supply of heat to property owners is exempt from VAT.

A-G Bobek considered first the need to clarify "who delivers what to whom and what is being heated?" He says that it appears that the heat is only provided to "the owners" (i.e. the three members of the association) and not to the residential tenants, who appear to have no part in the transactions. However, the order for reference did not make it clear whether the heating was supplied to the owners collectively (heating the common areas of the building) or individually (heating the areas that they themselves occupied).

It was also not clear if any consideration was provided; without consideration, there could be no taxable transaction. The A-G proceeded on the basis that the owners provided some consideration for the supply of heat, "since it is unlikely that the referring court would even pose such a question if there was no compensation whatsoever." Further, it would make a difference if the consideration was charged specifically for the supply of heat, or was part of a general charge for an array of facilities.

The A-G commented on the normal tests for "consideration" – the need for a "legal relationship between the parties". In his view, this was unhelpful – there was a legal relationship in some cases, such as *Apple & Pear Development Council*, where there was no consideration. The A-G considered that the legal relationship point was only engaged where there was "commensurability of benefit" linked to the payment rendered.

The Commission and the German government had submitted that the fact that the "suppliers" (the association) and the "recipients" (the owners) were identical, there could be no economic activity. The A-G did not accept that reasoning. According to art.9 PVD, "any activity of producers…" is to be regarded as an economic activity. Crucially, in addition, the association was a separate legal person from its owners. There was therefore no identity of persons.

The German government argued that the German law, which specifically exempts the supply of "maintenance, repair and other administrative purposes as well as the supply of heat and similar services" by property associations to property owners and co-owners, was simply the implementation of art.135(1)(l) PVD. Again, the A-G did not agree. Exemptions have to be interpreted and applied strictly: the supply of heat could not possibly fall within "leasing or letting of immoveable property" in its own right; it could only be exempt if it was held to be an ancillary supply for the better enjoyment of a principal exempt supply. In addition, the generation and supply of heat appeared to be an "active" transaction rather than sharing the "passive" nature of most rental activity according to the case law.

The A-G turned to the alternative scenarios that he had proposed:

- if the heat was supplied to the common areas of the property, i.e. to the owners collectively, in his view the situation was similar to that in *Apple & Pear Development Council* and there would be no taxable transaction;
- if the heat was supplied to the owners individually, the national court should consider whether there was "commensurability of benefit"; if there was, then the German law would incorrectly exempt something that ought to be taxable.

The opinion proposes to send the case back to the referring court for important clarification.

CJEU (A-G) (Case C-449/19): *WEG Tevesstraße v Finanzamt Villingen-Schwenningen*

4.4.8 Alleged bad faith

A Romanian company was subject to a criminal investigation which resulted in no further action being taken; however, the tax authority concluded that the company had improperly deducted input tax in respect of some fictitious transactions. It alleged that the suppliers (micro-entities subject to 3% tax) did not have the technical or logistical capacity to provide the services that they had invoiced. Part of the tax authority's evidence for this was the fact that company could not provide any corroboration for the transactions other than the tax invoice, even though a tax invoice was the only legal requirement for supporting a deduction.

The company appealed, arguing that it should not be held responsible for improper conduct by its suppliers. The Romanian court referred questions about the rights of the taxpayer to deduct "VAT and corporation tax"; the Romanian government argued that this was inadmissible, because there was no relevant EU law to apply on corporation tax. However, the CJEU held that it was admissible, because the referring court had explained the EU legal concepts that might apply in determining the purely internal dispute – matters concerning the rights of defendants in being presented with the case against them.

In this case, the tax authorities had refused to give relevant information from the investigation file to the taxpayer, and had not argued that there was any public interest reason warranting that refusal. This did not necessarily mean that the decision should be automatically annulled, but it was an irregularity in the assessing process. If the referring court concluded that the result of the investigation might have been different if the taxpayer had been given the relevant information at the right time, the assessment should be quashed.

The court then turned to the question of whether the tax authority could base an assessment on uncorroborated doubts about the existence of transactions where no additional evidence of those transactions could be produced by the taxpayer. The right to deduction was a fundamental part of the VAT system; however, the prevention of fraud and evasion was a legitimate objective. The standard MTIC principle was repeated: the trader can only be denied a deduction if it can be shown, on objective grounds, that he knew or should have known that the transactions were connected with fraud and evasion.

The requirements for establishing that connection were not set down in EU law and depended on the circumstances of the case, and the rules of evidence in each country, as long as those rules did not contravene the EU principles of effectiveness and equivalence. The court made the following comment about the obligation to check the good faith of a supplier:

"Although such a taxable person could be obliged, when there are indications pointing to an infringement or fraud, to make inquiries about the trader from whom he intends to purchase goods or services, in order to ascertain the latter's trustworthiness, the competent national tax

authorities cannot, however, as a general rule, require that taxable person, first, to ensure that the issuer of the invoice relating to the goods and services in respect of which the exercise of that right to deduct is sought was in possession of the goods at issue and was in a position to supply them and that he has complied with his obligations as regards the declaration and payment of VAT, in order to be satisfied that there are no irregularities or fraud at the level of the traders operating at an earlier stage of the transaction or, second, to be in possession of documents in that regard."

CJEU (Case C-430/19): *SC CF Srl v AJFPM and DGRFPC*

4.4.9 Deregistration and res judicata

A Romanian law firm applied in May 2015 to be deregistered with retrospective effect from 2002, and to be refunded the VAT paid from 1 January 2010 to 31 December 2014, on the grounds that it had been registered in error. The authorities did not respond to the request, and an action to force the issue was dismissed by the regional court in Bucharest. The action was based on an argument that the regional court had held in 2016, upheld by the Court of Appeal in 2018, that a law firm such as the applicant did not make supplies of services for consideration: the contracts concluded with its clients were contracts for legal assistance rather than for provision of services. It was not, therefore, a taxable person.

Questions were referred to the CJEU. The first appears very basic:

In the context of the application of Article 9(1) PVD, does the concept of "taxable person" include persons who practise the profession of lawyer?

Not surprisingly (apart from the length of the discussion and reference to precedent cases), the CJEU held that a person practising the profession of lawyer must be regarded as a taxable person within art.9.

The second is more interesting, because it appears that the applicant is trying to take the benefit of a decision taken by the Romanian court that might be wrong under EU law (but was not referred to the CJEU for confirmation of that question):

Does the principle of the primacy of EU law permit an exception to be made, in subsequent proceedings, to the authority of res judicata attaching to a final judicial decision in which it has been established, in essence, that, in accordance with national VAT legislation, as it is interpreted and applied, lawyers do not supply goods, do not carry out an economic activity and do not conclude contracts for the supply of services, but instead conclude contracts for legal assistance?

In this case, the CJEU noted the importance of the principle of res judicata: "In order to ensure stability of the law and legal relations, as well as the sound administration of justice, it is important that judicial decisions which have become definitive after all rights of appeal have been exhausted or after expiry of the time limits provided for in that regard can no longer be called into question… Therefore, EU law does not require a national court to disapply domestic rules of procedure conferring finality on a judgment, even if to do so would make it possible to remedy a domestic situation which is incompatible with EU law."

There is no EU legislation that sets rules on res judicata, so it is left to the Member States to apply their own rules. Those rules must be subject to the principles of equivalence (domestic claims must be treated no more favourably than cross-border claims) and effectiveness (it must not be excessively difficult or practically impossible to exercise rights). That meant that if the domestic rules of procedure allowed for res judicata to be set aside under certain conditions, then that must happen if those conditions were met, so that the situation would be brought back in line with EU law.

The CJEU went on to note that there were differences between the case on which the applicant sought to rely and its own situation: in particular, the period covered by the 2018 judgment was January 2011 to November 2014, which differed from both the period for which the refund was claimed, and the period for which the applicant wanted to be deregistered. As the judgment of 2018 was not compatible with EU law (because of the answer to the first question), the domestic court should not apply res judicata in favour of the applicant if the domestic rules of procedure allowed it to dismiss the action.

Further, an incorrect decision in relation to one tax year could not establish a binding precedent in relation to another tax year, even if res judicata applied: that would result in a continual incorrect application of the law, without it being possible to rectify the mistake.

Although there is some overlap in the periods considered by the 2018 judgment and the dispute in the present case, the answer to the second question refers to "identical" tax periods. It is clear that the CJEU considered that the application should be rejected.

CJEU (Case C-424/19): *Cabinet de avocat UR v Administraţia Sector 3 a Finanţelor Publice prin Direcţia Generală Regională a Finanţelor Publice Bucureşti*

4.4.10 Ancillary activities

A Romanian university lecturer exercised several professions independently, including those of chartered accountant, tax consultant, insolvency practitioner and lawyer, and also received an income as an author of articles and books. He was registered for income tax as a sole trader from 2008 under the heading "accounting activities", to cover his accountancy and tax consultancy work, based at his home address.

He claimed that the insolvency practice was based at a building which he co-owned with another individual, which was partially let to another VAT-registered company of which he was the managing partner. That company carried out varies financial consultancy activities.

In 2016, he was subject to a tax audit, when the tax authorities concluded that he had exceeded the VAT registration threshold (approximately €65,000) and should have been registered from 1 September 2012. The authorities took into account his income from the accountancy and tax consultancy work, his insolvency practice, his copyright income from writing, and his rental from the building; they disregarded his salary as a university lecturer and his legal work, which had already been subject to VAT under the registration of a partnership to which he belonged.

69% of his income came from insolvency work, 14% from tax and accountancy, and 17% from rental income. The tax authority concluded that the rental income was not an "ancillary operation" that might have been disregarded under the Romanian law on the small business exemption. The individual appealed against the decision and the resulting assessment, and questions were referred to the CJEU on the application of the rules in art.288 PVD.

The turnover which serves as a reference for the application of the regime provided for in this section is made up of the following amounts excluding VAT:

1) the amount of supplies of goods and services, insofar as they are taxed;

2) the amount of transactions exempted with the right to deduct VAT paid at the previous stage under Articles 110 and 111 of Article 125(1), Article 127 and Article 128(1);

3) the amount of transactions exempted under Articles 146 to 149 and Articles 151, 152 and 153;

4) the amount of real estate transactions, financial transactions referred to in Article 135(1) (b) to (g), and insurance benefits, unless these transactions are in the nature of ancillary transactions.

However, disposals of tangible or intangible investment goods of the company are not taken into account for the determination of turnover.

The court noted that the rules for small business exemption had to be interpreted strictly, and that they contained independent EU legal concepts that were directly effective. Rental income was likely to constitute an economic activity, but was also likely to be exempt within art.135.

There is no definition in the Directive of "ancillary transactions". It has been considered in the context of the rules on deduction in cases such as *Nordania Finans* (Case C-98/07), where the court referred back to the proposals for the 6th Directive. These explained the omission of ancillary transactions from the partial exemption proportion as necessary to properly reflect the actual use of costs in the taxable activity. This would be distorted by "the sale of investment goods and real estate or financial transactions which are carried out only incidentally, that is to say which are of only importance. secondary or accidental in relation to the company's overall turnover." Although the words used were not identical in some language versions of the PVD, the court was satisfied that the concepts were the same and served the same purpose.

The concept of "ancillary transaction" designates certain transactions which do not fall within the usual professional activity of the taxable person. This does not require the identification of a "principal activity", but is a stand-alone concept. The Court has held that an economic activity cannot be classified as "ancillary" if, in particular, it constitutes the direct, permanent and necessary extension of the usual taxable professional activity of the company concerned (*NCC Construction Danmark*, Case C-174/08). The tax authorities and the national courts must therefore take into account the information produced before them, in particular the nature of the immovable property concerned, the origin of the financing for the acquisition of that property and the use of it.

The court did not give a definitive answer in the case, but held that the referring court should consider whether the rental of the building was part of the usual professional activity of the taxable person, given that it was let to a company of which he was the managing partner, and it was the base of his insolvency practice. That may suggest that it will be held not to be ancillary.

CJEU (Case C-716/18): *CT v Romanian Tax Authorities*

4.5 Foreign refund reclaims

4.5.1 Failure to register in country of claim

A Belgian company rents pallets throughout the EU, buying pallets for rental to other group companies established in other states which sublet them to local customers. The company acquired pallets from a Romanian supplier during 2014. These pallets, along with others sourced from other countries and transported to Romania, were rented to its Romanian subsidiary. They were sublet to Romanian customers, who used them for transporting exported goods. They were reimported to Romania, where they were declared by the local subsidiary, which invoiced their value and the related VAT to the Belgian company. In June 2015 the Belgian company claimed a cross-border refund in respect of the VAT charged on purchases of pallets in Romania and also on reimportation of pallets into the country.

The Romanian authorities refused the claim on the basis that the appellant should have been registered for VAT in Romania. This was because it had moved pallets from other countries to Romania, and this would have required acquisition tax.

The company argued that the cross-border refund Directive 2008/9 had been incorrectly transposed into Romanian law, and it was entitled to a refund under that Directive regardless of a possible obligation to register; it also disputed whether there was an acquisition and such an obligation. Questions were referred to the CJEU:

1) Does the transport of pallets from one Member State to another Member State, so that these pallets are subsequently rented there to a taxable person established and identified for VAT in Romania, constitute a case of absence of transfer within the meaning of art.17(2) PVD?

2) Irrespective of the answer to the first question, is a taxable person within the meaning of art.9(1) PVD who is established in the territory of a Member State other than that of reimbursement considered to be a taxable person within the meaning of art.2(1) of Directive 2008/9, even if he is VAT identified or would be required to be VAT identified in the Member State of reimbursement?

3) Having regard to the provisions of Directive 2008/9, does the condition of not being identified for VAT in the Member State of reimbursement represent an additional condition with regard to those provided for in art.3 of Directive 2008/9 so that a taxable person established in another Member State and not in the Member State of reimbursement can benefit

from the right to reimbursement in circumstances such as those of the present case?

4) Should art.3 of Directive 2008/9 be interpreted in the sense that it precludes a practice of the national administration consisting in refusing the refund of VAT on the grounds of non-compliance of a condition provided exclusively in national law?

Art.17(2)(g) PVD states that "the temporary use of this item, in the territory of the Member State of arrival of the consignment or transport, for the purposes of providing services by the taxable person established in the Member State of departure from shipping or transporting the goods" is not considered to be a transfer to another Member State. The exceptions in art.17(2) are considered to be an "exhaustive list" and so must be interpreted strictly. This meant that it could not apply if the goods were despatched from a different country to that in which the owner was established; nor could it apply to situations in which indefinite or prolonged use, or the destruction of the goods (so they would not be returned), were envisaged.

In this case, the relevant despatch was by the appellant in Belgium to its subsidiary in Romania. It would be for the Romanian court to determine whether the use of the pallets in Romania was of a temporary nature. This assessment would depend on the contracts and on the nature of the goods themselves.

If the pallets were acquired in other Member States, the referring court should establish whether they had been despatched from Belgium to Romania (which seems unlikely). If either of these conditions were found to be breached, the arrival of the pallets in Romania would be an acquisition and would render the Belgian company registrable in Romania.

The remaining questions were considered together. Directive 2008/9 precludes a cross-border claim if the claimant is established in the country of claim. The conditions for entitlement are that the claimant must neither have the seat of the economic activity, nor a permanent or fixed establishment, in the country; and the claimant must not have made any supplies of goods or services that are deemed to have taken place in the country. However, neither art.170 PVD nor art.3 Directive 2008/9, nor any other provision of those directives, subordinate the right for a taxable person established in another Member State to obtain the VAT reimbursement under any formal condition of no VAT identification or no obligation to VAT identification in the Member State of reimbursement. Deduction of VAT is a fundamental right under the PVD, and the cross-border system is supposed to replicate that fundamental right.

The court noted that, according to precedents, the existence of a VAT registration in the country did not preclude a cross-border claim (e.g. *Daimler* Case C-318/11). Registration is described as "only a formal requirement for control purposes", and formal requirements cannot affect the right to deduct where the substantive conditions are fulfilled. Art.171a PVD allowed Member States to exclude certain taxpayers from the cross-border refund system, but only if they allowed them deduction under art.168 instead, which Romania did not do.

The court concluded that the Belgian company was making supplies in Romania for which its customer (the subsidiary) was liable for the output tax; it did not have an establishment or a fixed establishment in the country; it was therefore entitled to a cross-border refund.

CJEU (Case C-242/19): *CHEP Equipment Pooling NV v Agenţia Naţională de Administrare Fiscală - Direcţia Generală Regională a Finanţelor Publice Bucureşti - Serviciul soluţionare contestaţii and another*

5. INPUTS

5.1 Economic activity

5.1.1 Mixed holding companies

A Portuguese company planned to acquire a subsidiary to which it would have made taxable supplies of management services, and incurred input tax on consultancy and on services related to the issue of corporate bonds. In the event, the acquisition did not take place, and the proceeds of the bond issue were instead made available to the holding company of the group as an exempt loan. The company considered that it was entitled to a deduction on the basis of the intention underlying the incurring of the inputs, or their categorisation as overheads of the general activity of an active holding company; the tax authority took the opposite view on the basis of the outcome. Questions were referred to the CJEU, and Advocate-General Kokott has given an opinion.

The referring court formulated its first question badly, because it failed to take into account existing case law that showed the mere acquisition of shares to be a non-economic activity. The A-G reformulated the question to ask whether a mixed holding company (one that supplies taxable services to some subsidiaries but also has non-economic holdings where no taxable services are supplied) is entitled to deduct input tax in respect of consultancy services connected with the market survey with a view to the acquisition of shares; in particular, where there was an intention to make taxable supplies to the acquired company, but that acquisition did not take place.

The A-G observed that the answer was found in precedents such as *Ryanair*. A mixed holding company can be a taxable person; input tax may be deducted in respect of preparation for activities not subsequently carried out; and a disproportion between the amount of the deduction and the amount of a holding company's tax liability on the basis of its planned management services, which regularly occurs in these cases, is immaterial.

The appellant company was a mixed holding company rather than a "mere *Polysar*" investment holding company, so it was in principle a taxable person. The failure to carry through the transaction did not restrict the initial right to deduct, in accordance with *Ryanair*, as there was an intention to become involved in management and to make taxable supplies.

The only question was whether there was a direct and immediate link between the expenditure and the services which the appellant intended to supply to the target company. The A-G sets out the two bases for such a link – cost components of particular outputs, and general overheads that are linked to the whole activity – and concludes that the appellant is entitled to deduct these consultancy costs. However, it is not completely clear which principle the A-G is applying: what she says is that the "expenditure has a direct and immediate link with the planned taxable services", which suggests that she regards the inputs as cost components of future services supplied to the subsidiary, rather than the general overheads of a holding company.

The A-G noted that the deduction claimed was nearly €1 million, which would be much more than the output tax chargeable on future services. However, VAT law did not require there to be a proportionate relationship between input tax and output tax; the services would be taxable over a number of years, and the principle of neutrality of legal form suggested that expenditure for the management of the undertaking should be relieved in full.

The second question concerned the deductibility of the costs relating to the bond issue. The A-G also reformulated that to consider whether it was the planned use of the funds or the actual use that counted, and whether it was possible for the appellant to justify deduction on the basis of later use by the rest of the group for taxable activities.

In this case, the A-G was clear that these inputs were not "general costs". The principle of general use/general overheads can only be used if there is no link to particular outputs; *Sveda* and *Iberdrola* (described by the A-G as "generous" decisions) concerned use for disregarded activities rather than exempt ones. The actual use of the inputs was more precise than the intended use, and it precluded a deduction.

The later use for taxable purposes, even if it could be made out as a fact, would be unlikely to lead to an adjustment of the non-deductibility of the inputs. The expenditure was not a "capital item", and the conditions of art.184 and 185 PVD did not appear to apply. The services were consumed immediately when the capital was raised, and subsequent events did not change the entitlement.

In conclusion, the A-G recommended that the court finds that the inputs on consultancy services were deductible, as long as the referring court confirmed an intention to make taxable supplies, regardless of the fact that the acquisition did not take place; but that the inputs relating to the bond issue were not deductible, based on the actual use to make an exempt onward loan.

CJEU (A-G) (Case C-42/19): *Sonaecom SGPS SA v Autoridade Tributária e Aduaneira*

5.1.2 Group transactions

A holding company formed a group with its subsidiaries, AG and BG. AG had a licence to operate a limestone quarry, but was required to develop a public road to provide access to it. The local municipality agreed to undertake to plan and implement the extension of the road, and make it available to AG, and AG agreed to bear all the costs of the development. AG commissioned BG to carry out the extension. The HC deducted as input tax VAT charged on the development work by BG. The tax office took the view that the company had provided the municipality with free-of-charge services, and raised an assessment for output tax on the work.

The referring court held that the input tax should not have been deducted in the first place, because it was used for a non-business purpose. However, the court then had doubts about the possible implications of the CJEU decisions in *Sveda* and *Iberdrola Inmobiliaria*. It therefore referred questions on the deduction of input tax, the possibility of a barter output in relation to the exchange of the road for the licence, and the possibility

of a deemed supply of services in respect of the free supply to the municipality.

The CJEU essentially applied the same principles as in *Iberdrola*: if the work on the road was essential for the exploitation of the quarry, the fact that the public could also use the road for free was immaterial. It would be for the referring court to determine whether the costs incurred were solely to enable the quarry to be exploited, or if they went further – in which case there should be an apportionment and a partial deduction.

Turning to the question of barter, the court noted that the licence to operate the quarry had been granted unilaterally by the Regional Council, but the agreement concerning the road was with the local municipality. There was therefore no direct or immediate link between the two that could constitute a barter transaction. Apart from the different parties involved, a unilateral act by a public authority cannot, according to precedent, create a legal relationship entailing reciprocal performance.

The court examined the rules on supplies made without consideration (referring to the 6th Directive provisions in art.5(6), because of the time at which the disputed transactions took place), and concluded that the rules were not engaged. This was because the works were carried out to meet the needs of the taxable person, and were not put to any private or non-business purpose by it.

CJEU (Case C‑ 528/19): *Mitteldeutsche Hartstein-Industrie AG v Finanzamt Y*

5.2 Who receives the supply?

5.2.1 Indirect mail

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

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

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

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

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

The Tribunal examined the relationship between the company and one of the intermediaries, Colemead Ltd. The sole director of that company appeared to have no knowledge of how it operated, and was paid a trivial and irregular amount of money for what he did. The input tax claimed of £208,829 on "supplies" by Colemead was disallowed on the basis of cases including *Longridge*, *Wakefield College* and *Finland* – the company was not in business.

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

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

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

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

The appeal was dismissed in relation to the input tax claims, and allowed in part in relation to the penalties.

First-Tier Tribunal (TC07777): *Y4 Express Ltd*

5.3 Partial exemption

5.3.1 Capital goods

In 2003, a German retirement home constructed a cafeteria. It claimed full deduction for the input tax on the grounds that the residents (recipients of exempt supplies) would not use the cafeteria: it would only make taxable supplies to visitors and guests. Following an audit in 2006, the tax office argued that this was unlikely, and a capital goods scheme adjustment disallowing 10% was agreed, covering each of the years from 2003 onwards.

Following a second audit, the tax office found that, from 2009 to 2012, there were no external sales in the cafeteria, and the company was removed from the register in February 2013. The tax office made further adjustments on the basis that the cafeteria was not used at all for taxable outputs.

The company appealed, arguing that the cafeteria had been closed because it was not economically viable and access had been blocked for safety reasons; there had therefore been no increase in exempt use. An adjustment under the CGS should not follow from "non-use" because of a poor investment decision. This was effectively a circumstance beyond the taxpayer's control, and the intention to use for taxable purposes had not changed.

The referring court asked whether adjustments were required under art.185 or art.187 PVD where an asset ceased to be used. The CJEU referred to the precedent of *Imofloresima – Investimentos Imobiliarios* (Case C-672/16), in which it was held that the right of deduction was retained where a taxable person did not use the goods and services received due to circumstances outside his control. However, the facts were materially different in the present case.

The CJEU drew a distinction between a trader who acquires goods and services with a purely taxable intention which is then frustrated, so that the goods and services are never used for anything, and a trader who acquires goods and services and uses them for mixed outputs for six years, and then ceases to use them for taxed transactions while continuing to make exempt supplies. The judgment states "the cafeteria's premises, which are an integral part of a retirement home operated as an activity exempt from VAT, did not remain empty, but were used from then on exclusively for exempt transactions." This seems to contradict the earlier statement that "access to the cafeteria was blocked"; however, it may simply mean that the trader could not regard part of the building as a separate asset in determining deduction.

The answer states that the PVD does not preclude national legislation that requires an adjustment in circumstances where taxed transactions have ceased in the premises but the trader has continued to carry out exempt transactions in those premises. It would be useful to have a better description of the facts to be sure of the underlying context of this conclusion.

CJEU (Case C-374/19): *HF v Finanzamt Bad Neuenahr-Ahrweiler*

5.3.2 Capital goods or clawback?

In 2013, a property company built an apartment complex comprising seven residential apartments on a plot of land belonging to it. As it intended at the time to use the property for taxable purposes, it deducted in full the VAT incurred on the construction. From 1 August 2014, it leased four of the apartments, treating the rent as exempt; the other three apartments were not used in 2014. The Netherlands law required the total clawback of the input tax claimed. The trader argued that a partial adjustment should be required under art.187 PVD, and questions were referred to the CJEU.

The court noted that articles 184 and 185 require adjustments if the conditions that justified an initial deduction under art.168 have changed. The provisions are drafted in very general terms; there is an obligation to make an adjustment, but art.186 explicitly delegates to the Member State the way in which this adjustment shall be operated.

The court ruled that the exempt letting of four of the apartments engaged art.184. The question was then whether a single clawback was permitted as something prescribed by the Member State under art.186, or whether the capital goods scheme in art.187 had to be followed. The court ruled that this was a situation in which art.184 applied: the first use for a wholly exempt purpose indicated that the factors that had justified the initial deduction had changed. This was consistent with fiscal neutrality.

The court's answer was expressed as allowing a capital goods scheme that required a single adjustment in the first adjustment interval where the use was fully exempt; however, that is effectively saying that the capital goods scheme does not apply in that circumstance.

CJEU (Case C-791/18): *Stichting Schoonzicht v Staatssecretaris van Financiën*

5.3.3 Hire purchase

HMRC have updated *R&C Brief 8/2020* to clarify its position on the calculation for recovering input tax on overheads incurred in relation to the supply of goods on hire purchase. The calculation for output values-based method of apportionment under the heading 'HMRC position' has been updated to confirm that where the amount of credit is less than the total value of the asset, then both the amount shown as the value of the asset and the value of the exempt credit would be reduced.

This is reflected in HMRC's example, which has not been changed:

The value of asset is £10,000 and the value of credit provided is £8,000 at 5% interest over 5 years plus additional charges of £100 (for example an exempt arrangement fee).

The value is reduced to credit amount = £8,000.

Charge for finance (interest amount) is = £1,033.79.

Additional charges (exempt arrangement) = £100.

That is, £8,000 divided by (£8,000+£8,000+£1,033.79+£100) multiplied by 100 = £8,000 divided by £17,133.79 multiplied by £100 = 46.69%.

Revenue & Customs Brief 8/2020

5.3.4 Framework for Higher Education

HMRC have updated their *Framework for HEI Partial Exemption Special Methods*. This Framework for Higher Education Institutions (HEIs) is part of a series of frameworks for Partial Exemption Special Methods. It provides guidance on formulating PE special methods for HEIs, in particular:

- how to determine a fair 'value' for supplies of grant-supported education
- when to add 'sectors' to a PE method, and

- how to identify and deal with ‘distorting supplies’

It is aimed at HEI staff with responsibility for partial exemption, advisers to HEIs and HMRC staff.

The Framework is not mandatory and does not replace the content of any published HMRC guidance. Adopting its principles will enable HMRC to more readily give consideration to a PE special method proposal for which a Statutory Declaration has been made.

www.gov.uk/guidance/partial-exemption-frameworks

5.4 Cars

5.4.1 Salary sacrifice

A NHS Trust applied for judicial review of HMRC’s refusal to refund VAT incurred on leasing of cars and claimed under VATA 1994 s.41(3). The cars were provided to employees under a salary sacrifice scheme. HMRC had refunded 50% of the VAT, but the Trust claimed the remaining 50% by way of error correction. The appeal had to be made by way of judicial review in the Upper Tribunal because a claim under s.41 is not an appealable matter under s.83. The Trust was granted permission to pursue its claim that:

(1) HMRC erred in law in concluding that the Car Scheme constituted a business activity of the Trust such that s.41(3) was not engaged (“the Business or Economic Activity Issue”);

(2) the Decision breached the Trust’s legitimate expectations (“the Legitimate Expectation Issue”); and

(3) HMRC erred in law in imposing a four-year cap, as extended by the HMRC guidance, on the Trust’s Claim (“the Time Bar Issue”) (the VAT claimed was incurred between 1 January 2012 and 31 January 2017, and was claimed on 31 March 2017 – HMRC ruled that tax incurred before 1 October 2012 was out of time).

The UT decision began with a note of the status of public bodies under the PVD (essentially non-taxable unless they engage in some economic activities) and UK rules relevant to the car scheme – SI 1992/630 on salary sacrifice, which desupplied the supply of the car in such circumstances, and SI 1992/3222, which blocked 50% of the input tax on leased cars. The judge noted that s.41(3) and directions made under it were introduced to remove the disincentive involved in placing certain public service contracts with external suppliers in the private sector.

The Treasury direction made under s.41(3) in December 2002 set out the categories of Government department that may claim refunds of VAT (including NHS Trusts) and lists the services in relation to which VAT may be refunded. This includes “hire of vehicles including repair and maintenance”, subject to the following condition:

(a) either the supply of those services or goods is not for the purpose of:

(i) any business carried on by the department; or

(ii) ... and (b) the department complies with the requirements of [HMRC] both as to the time, form and manner of making the claim and also on the

keeping, preservation and production of records relating to the supply, acquisition or importation in question.

It was common ground that "business carried on" had the same meaning as "economic activity" in art.9(1) PVD. The burden of proof lay with the Trust to show, on the balance of probabilities, that its activity of leasing cars to its employees was not a business or economic activity.

Until the end of 2011, the Trust had recovered all the VAT incurred on cars on the basis that it was incurred for the non-business purpose of providing statutory healthcare. HMRC changed their guidance with effect from the beginning of 2012 to bring the treatment of such car use in line with input tax for commercial organisations, disallowing half the VAT on leasing to reflect private use. The Trust had argued in correspondence that this ought to be a matter for legislation rather than guidance.

The Trust's counsel argued that there were three reasons the claim should succeed:

- SI 1992/630 treated the salary sacrifice scheme as not involving a supply;
- the car scheme was not an economic activity;
- the Trust entered into the car scheme while operating under a special legal regime as a public body.

HMRC did not agree that the effect of the de-supply order was to take the activity outside the scope of "business". They argued that the deeming provision only provided that the activity was not to be charged as a supply for consideration, and had no other effects. There was precedent on the extent to which a "statutory fiction" should be applied: "the correct approach in construing a deeming provision to be to give the words used their ordinary and natural meaning, consistent so far as possible with the policy of the Act and the purposes of the provisions so far as such policy and purposes can be ascertained; but if such construction would lead to injustice or absurdity, the application of the statutory fiction should be limited to the extent needed to avoid such injustice or absurdity, unless such application would clearly be within the purposes of the fiction" (*Marshall v Kerr* 1993).

The judge accepted the Trust's first argument: the de-supply order meant that the car scheme could not be treated as an economic activity, because that required "supplies for consideration". It was not part of a wider economic activity of the Trust; it therefore fell within s.41(3). The Trust was correct in its view that, if the blocking order was supposed to apply to s.41 claims as HMRC argued, that could only be achieved by changing the legislation.

In case this conclusion was incorrect, the UT went on to consider whether, in the absence of the de-supply order, it would have regarded the car scheme as an economic activity. Here, it agreed with HMRC. It discussed the application of *Wakefield College*, *Borsele* and *Finland*, and concluded that it satisfied the tests. Although it was an ancillary activity for the Trust, nevertheless it was a common activity of employers and operated within the framework of a marketplace, and the Trust was not acting as a final consumer in the same way that the local authority acted in *Borsele*. The Trust supplied cars, rather than consuming them.

The UT also agreed with HMRC on the “special legal regime” point: it was clear from the language of art.13(1) PVD that public authorities that engage in activities or transactions under a special legal regime are to be regarded as taxable persons in respect of those activities or transactions where their treatment as non-taxable persons would lead to significant distortions of competition. There was no doubt that the ability of the Trust to recover VAT that would be irrecoverable by commercial car leasing businesses would lead to significant distortions of competition. In any event, the cars were not provided under a special legal regime because they were provided under the same legal conditions as those that would apply to taxable persons leasing cars to businesses or private individuals and the Trust did not provide any evidence or submissions to the contrary.

As the Trust succeeded on the technical ground, it was not necessary for the Tribunal to consider its legitimate expectations. However, it was necessary to consider the effect of the time-bar. The claim was not made under s.80, and therefore the standard four-year limit did not apply; however, HMRC had the power to set “reasonable conditions” for a s.41 claim. The UT considered that a four-year limit was a reasonable condition, and upheld the limitation on the claim to the VAT incurred from 1 October 2012.

HMRC appealed to the Court of Appeal, where the leading judgment was given by Lewison LJ. He summarised HMRC’s argument as a contention that “supply” and “business” were distinct, and it was not a precondition of economic activity that supplies have taken place. The deeming provision in the de-supply order should only be given a limited effect in accordance with its purpose.

The judge commented that the way in which the blocking order operated for company cars appeared to depend on the de-supplying of the provision of a car to an employee, which strengthened the Trust’s case – the input tax was not deductible because the provision was not counted as an economic activity. That would engage s.41.

The judge also noted the arguments based on *Wakefield College*, *Gemeente Borsele* and *MVM* that the making of supplies for consideration was a necessary condition for a finding of economic activity. If there were no supplies, there could be no business. In response, HMRC’s representative argued that the *Ghent Coal Terminal* decision showed that it was not always necessary to make supplies: the appellant in that case was allowed to deduct and keep input tax on the basis of carrying on an economic activity, even though its intention to make supplies was frustrated by the compulsory purchase of its asset. The judge did not accept this argument: that related to an intention to make taxable supplies and the right to deduct input tax, whereas in this case there were no taxable supplies.

Counsel for HMRC observed that the de-supply order was contrary to EU law because it was contradicted by the CJEU decision in *AstraZeneca* (Case C-40/09). The judge expressed surprise that it had not been repealed in the ten years since that decision, but held that the Trust was entitled to rely on it. It seems that counsel only made a half-hearted attempt to invoke the principle of conforming construction to override it.

The UT had come to the correct decision for the correct reasons, and HMRC’s appeal was dismissed.

Court of Appeal: *HMRC v Northumbria Healthcare NHS Foundation Trust*

5.5 Business entertainment

Nothing to report.

5.6 Non-business use of supplies

5.6.1 Legal fees

A farming partnership (grandfather GF, father F and son S) appealed against a decision not to allow input tax on the cost of legal services incurred in bringing proceedings in the High Court to rescind certain transfers of land to a discretionary trust. The trust had been set up in 2011 with the intention of making sure that the land would remain available for farming in the event of the death of the senior partner (GF). When it was discovered that this transaction would give rise to "crushing" CGT liabilities, the partnership successfully sought to have the transfers cancelled and the discretionary trust set aside.

After two High Court rulings in September 2015 and April 2016, the partnership's agent wrote to HMRC asking for repayment of the VAT on the legal costs incurred. This had not been claimed on the quarterly VAT returns. The firm had made a claim against the insurers of the solicitors who had originally advised on setting up the trust (and, it was claimed, had said that no CGT would be payable); the insurers had paid out an amount that was greater than the VAT-inclusive amount of the legal fees, but less than the total amount that had been claimed (because numerous other matters were also included in the claim).

The judge noted that there had to be a "direct and immediate link" between expenditure and one or more output transactions, or between the expenditure and the claimant's economic activities as a whole. It was not enough that the business would benefit; there has to be a real connection between the expenditure and the business that is being carried on.

GF died in 2015. F explained to the Tribunal that in 2011 it was believed that GF had written a will leaving his land equally to his four children, three of whom were not involved in farming. The trust had been set up to protect the land for the partnership, because it was thought at the time that GF was not capable of validly changing his will. In the event, on his death the land was left only to F. He argued that all the land was at all times a partnership asset, shown in the partnership accounts as such; HMRC had ruled that the land was owned by the partners individually, which was part of the basis for their decision that the legal costs were incurred by the partners individually rather than by the registered person.

The judge noted that the trust deed had not been produced in evidence. However, other sources suggested the partnership was not a beneficiary of the trust; the effect of the arrangement was not to preserve the land as a partnership asset. The judge concluded that the business might have benefited from the arrangements established in the trust, but there was no nexus between the establishment of the trust and the business that would have justified claiming input tax on the legal costs of setting it up. Regardless of whether the CGT liabilities that rescinding the trust sought to avoid would be incurred individually by the partners or by the firm, if setting up the trust had no nexus with the business, neither did undoing it.

It was therefore unnecessary to consider HMRC's separate argument that the insurance proceeds had already refunded the VAT to the partnership. The firm was not entitled to claim it as input tax in any case, and the appeal was dismissed.

First-Tier Tribunal (TC07759): *T & C Bainbridge Farming Partnership*

5.7 Bad debt relief

5.7.1 Payment of invoices

In July 2016 HMRC disallowed input tax on a purchase of stock and other assets from a connected company in period 12/13 on the grounds that it had not been paid for within 6 months of the date of acquisition (VATA 1994 s.26A). At the hearing, HMRC also argued that the company did not hold a proper VAT invoice. The company withdrew an appeal against disallowance of input tax on the purchase of several properties at the same time, but maintained its appeal in relation to the stock.

The company argued that the stock had been transferred in satisfaction of a debt owed by the transferor to the taxpayer, and it had therefore been paid for in full at the time of supply. It had held a debenture over the assets of the transferor company, and it had agreed to reduce the amount outstanding on its loan by the VAT-inclusive price of the goods transferred in December 2013. It sold the goods to another party in January 2014; in November 2014, the transferor company was wound up by an order in the High Court of Justice of Northern Ireland. It was insolvent and owed HMRC a substantial amount; it seems likely that the output tax on the December 2013 transaction would not have been paid, although that point was not considered in any detail by the Tribunal.

HMRC conducted a visit in 2015 and concluded that the stock had not been paid for. That decision was maintained on review and the company appealed to the Tribunal.

The judge considered that the witness evidence of the company's director and external accountant was vague and unconvincing. There was no adequate explanation for the existence of the loan, and therefore the company had not satisfied the burden of proof that the loan had been reduced so as to constitute payment for the stock. This meant that it was not necessary for HMRC to rely on the absence of the purchase invoice, but for completeness the Tribunal considered the argument. It seemed unlikely that such a significant invoice would go missing for no explained reason, as seemed to be the company's argument. It was more probable that it never existed.

The appeal was dismissed.

First-Tier Tribunal (TC07735): *Stonypath Developments Ltd*

5.7.2 Out of time

A taxpayer appealed against assessments disallowing a total of £25,173 of input tax claimed in the periods 10/10 to 07/11. There were a number of procedural disputes about admission of evidence; Judge Anne Fairpo decided that, in the interests of a fair hearing, extra material put forward by both sides should all be admitted.

The problem arose out of a company business that effectively closed in 2005, but which had a number of outstanding factored invoices. The owner filled in a VAT68 to transfer the business to herself as a going concern in 2008, taking on the company's VAT number. Shortly after that, the company was dissolved.

The sole trade made repayment claims for a long period to 10/10 and for quarterly periods after that to 01/11, 04/11 and 07/11. No output tax was declared; the input tax claimed was all repaid by HMRC (and was all subsequently assessed for recovery). In January 2012 HMRC requested a control visit, but the trader refused, as she was in a dispute over what are referred to as “the Conduct Allegations”. The sole trade was subsequently deregistered at the trader’s request on the basis that she had ceased to trade and “had only been collecting bad debts”.

HMRC then made specific enquiries into bad debt claims, and concluded that the last supplies were made in 2006. Further information was requested about all the input tax claims; as this was not provided, HMRC raised assessments for all the tax. Following further correspondence, the trader appealed to the Tribunal in May 2016.

The Tribunal agreed with HMRC that the bad debt claims could not be in time, because they were made more than four and a half years after the trader had last declared any output tax. An argument based on “reissuing invoices following reassignment by a factoring company” held no weight; it was also not possible to consider an argument that the claims had been made following advice from an officer of HMRC.

The trader also argued that HMRC had had all the information required to raise an assessment for more than a year, and the assessment was therefore raised out of time. HMRC argued that they did not have sufficient information until correspondence between a new officer to the case and the trader’s representatives in September 2013.

The judge noted that the disputed returns had all contained significant amounts in Box 6, without any figures in Box 1, and substantial amounts in Box 7, even though there were no inputs – bad debts are not supposed to be included in Box 7, even if a claim in relation to them is shown in Box 4. The trader’s assertion that “HMRC had been told that the sole trade was only attempting to collect bad debts” would not have been obviously supported by these returns; the judge concluded that HMRC did not have sufficient information until more was provided in September 2013, and therefore the assessments were in time.

The trader disputed that the assessment had been raised to best judgement on the grounds that she believed it to be “vindictive”, in connection with the Conduct Allegations. However, the judge considered that it was fully supported by the evidence available: HMRC were entitled under VATA 1994 s.73(2) to raise an assessment to recover VAT that should not have been repaid to a taxpayer, and this fell squarely within that provision.

The appeal was dismissed.

First-Tier Tribunal (TC07744): *Lesley Cook*

5.7.3 BDR and deferral of payments

The technical officers at CIOT raised a question with HMRC in relation to the following scenario:

- a payment on account trader has entered output tax in relation to supplies made in the quarter to 31 March 2020;

- some of the VAT for that period has been deferred under the Covid rules (the POA due on 31 March and the balancing payment due on 30 April);
- the trader is entitled to bad debt relief in relation to the supplies because the invoices are unpaid six months after the later of the due date and the date of the supply.

A supply made in the quarter to March is normally eligible for BDR in the return for the quarter to September, or at latest December, if it has not been paid. However, the law refers to output tax having been "accounted for and paid". In this case, some of the VAT for the March quarter has not been paid.

HMRC state that, where a supplier has not paid HMRC in full in any given VAT quarter, they should apportion any VAT paid across all supplies made in the period and claim the proportion of VAT that is applicable to the unpaid supplies. As payments to HMRC do not relate to individual supplies but the total value of VAT due on all their supplies, a supplier cannot choose which supplies part-payments made to HMRC were for. Thus, if a supplier paid x% of the tax due for the VAT period when it made the supplies, it can claim that same x% of the VAT on bad debts subsequently arising from the supplies it made in that VAT quarter.

Presumably, when the deferred VAT is later paid, the remainder of the bad debt relief can be claimed on the return for that period, provided that the invoices remain outstanding at that time.

www.tax.org.uk/policy-technical/technical-news/covid-19-interaction-between-vat-bad-debt-relief-payments-account

5.8 Other input tax problems

5.8.1 MTIC fraud

HMRC assessed a company for involvement in a missing trader fraud in four monthly return periods in 2013, involving input tax claims of just over £800,000. The decision starts with a discussion of the possible need to adjourn the hearing in order to allow the company to call further witnesses; HMRC's counsel had argued that their absence from the hearing suggested that the company was trying to evade scrutiny of their part in the activities. The judge decided that it would be unfair to HMRC to adjourn the proceedings or to allow the submission of late witness statements from the two individuals, even if they might be relevant. It should have been apparent to the company early in the proceedings that these witness statements might be needed.

The company had traded in telecommunications services. The judge examined the history of the business and set out the precedent case law on disallowing input tax for "means of knowledge", before examining the arguments of the parties. HMRC established that the company's transactions were connected with tax losses both directly through "dirty" chains and indirectly through "clean" chains (contra-trading).

The company's counsel listed a number of factors that distinguished this situation from the "normal" MTIC case. The Tribunal considered first the credibility of the only company witness who appeared at the hearing and was subject to cross-examination, because the judge's conclusions on his credibility "pervaded" the findings of fact that followed. The Tribunal found the witness to be honest and credible, and concluded that he was seeking to explain matters openly to the Tribunal. However, the judge did not accept the counsel's argument that this meant the appeal should be allowed. There were other directors who might have had actual knowledge; and the honesty of this director did not preclude a finding that he ought to have known of the connection with fraud.

The Tribunal decided it was entitled to draw a conclusion from the fact that almost 100% of the input tax claimed was related to tax losses; however, in the end, it attached no weight to that fact. The company had only started to trade in June 2013, its turnover increased exponentially, and it only traded with a single supplier and single customer in those periods. The director was aware of the risk of fraud in the sector. The judge refused to draw any inference in either direction from the company's application to move onto monthly returns in August 2013 – it could indicate a wish to enjoy the fruits of a fraud more quickly, or it could be legitimate, as well as "putting the company on HMRC's radar".

After further detailed consideration of the due diligence, sources of funding and other matters, Judge Jeanette Zaman concluded that the company – through the other directors – actually knew of the connection to fraud. In addition, the company as a whole should have known, based on the failure to carry out more than perfunctory due diligence and the failure to question the economics of the business that were "too good to be true". The appeal was dismissed.

First-Tier Tribunal (TC07731): *Askaris Information Technology Ltd*

HMRC denied deduction for a total of £2.66m of input tax in a company's periods from 09/15 to 04/16. 200 transactions were traced back to 9 defaulting traders, but all of the purchases were from one trader, Whitmount. The subject matter was mainly soft drinks and confectionery. Judge Aleksander's decision goes through the evidence in great detail, and shows that he asked the witnesses a number of questions himself to clarify their answers (rather than simply recording cross-examination by the respective counsel).

On the basis of a cumulation of evidence, the judge found that the director had "blind-eye" knowledge of what was going on. The appeal was therefore dismissed, after over 360 paragraphs. The summing up is a good illustration of the things that a trader should not turn a blind eye to:

In reaching our finding that Mr Burden had such blind-eye knowledge, we have taken into account the cumulative impact of the following in particular:

(1) That Mr Burden (and other members of Cavendish's staff) had been warned on a number of occasions about the risk of MTIC fraud, and had been provided with advice and information on MTIC fraud, and how to spot it and guard against it – including discussions about MTIC fraud when HMRC officers visited Cavendish, PN726, the "How to spot missing trader fraud" leaflet, and various letters on the topic;

(2) Although warned by HMRC that Cavendish should verify the integrity of their supply chain, and should consider the diligence undertaken by Whitmount on their own suppliers, Mr Burden neglected to review Whitmount's own diligence files;

(3) Having received a tax loss letter from HMRC in respect of goods purchased from Whitmount on 2 June 2015, Mr Burden was content to rely on Whitmount's unsubstantiated assurance that they had ceased buying from the supplier in question, and did not undertake any further diligence enquiries into Whitmount (such as, for example, FITTED checks);

(4) That Whitmount was Cavendish's sole supplier of FMCGs for their export trading business, even though Whitmount were not able always to supply goods to meet the requests of Cavendish's customers, and that goods previously supplied by Whitmount had been the subject of a tax loss letter;

(5) That the diligence information obtained in respect of MAK Logistics and Handelspost was not that which would be expected for a genuine commercial trader;

(6) Mr Burden's approach to due diligence as "just getting pieces of paper";

(7) That Whitmount were prepared to deliver goods to Poland at the same (delivered) price as for delivery to the Netherlands, and provided pricing tables to Cavendish which showed the same delivered price irrespective of the destination in continental EU;

(8) Mr Burden's disinterest in the terms under which Cavendish did business with their suppliers and customers, including his indifference to the risk to Cavendish of non-delivery or damage during transport;

(9) Mr Burden's disinterest in the insurance arrangements for the goods being bought and sold;

(10) That Mr Burden decided to stop all trading with Whitmount following the discovery that Handelspost's VAT registration had been cancelled, even though Cavendish had other (apparently) legitimate customers for FMCGs;

(11) The substantial turnover (and associated profits) generated by Cavendish from a business that was essentially free of all risks (at least in relation to the transactions subject to this appeal).

First-Tier Tribunal (TC07741): *Cavendish Ships Stores Ltd*

5.8.2 Alternative evidence

A company appealed against HMRC decisions in relation to three matters:

- the refusal to accept alternative evidence to validate deduction of input tax in the absence of proper VAT invoices for the purchase of several vehicles;
- the refusal to accept zero-rating of "export hire" of vehicles;
- the treatment of an unexplained receipt of £341,960 in the accounts.

The company had submitted a series of repayment returns; HMRC reduced the repayments to zero and replaced them with assessments, representing the net effect of the three adjustments set out above (and, initially, some other minor issues that were not before the Tribunal). There was disagreement between the parties about the level of cooperation during the enquiry: "The appellant's complaints were principally that they provided what was asked for, it was difficult if not impossible to deliver the information and HMRC ignored what was provided. HMRC complained that the documents and data were not provided, it was provided late and what was provided was incomplete."

The company sought to buy cars for export to the Republic of Ireland. As dealers were unwilling to sell to someone who was doing this, the purchases were generally not made by the trader itself, but by dormant subsidiaries (that were not VAT-registered) or by the director personally. The judge accepted that this was a common practice, although the details of how it is carried on may vary.

A number of supplies of car hire had been treated as "zero rated" (or outside the scope) on the basis that the customers were in the RoI. HMRC listed a number of defects in the invoices that they said did not justify a nil VAT charge.

The unexplained receipt was described by the director as a loan from a friend. The HMRC officer did not accept this, as no further information about it was provided, and raised an assessment based on the assumption that it was a VAT-inclusive receipt for a standard rated supply.

In respect of the input tax dispute, the trader relied heavily on the FTT decision in *Boyce* (TC04651), which dealt with a similar situation. However, the Upper Tribunal had overturned the FTT decision in 2017, before the hearing of this appeal. The judge only discovered this after the hearing, and asked for written submissions about it. The FTT had misunderstood the doctrine of effectiveness; in effect, the trader had chosen to operate in a way that resulted in it not having proper VAT invoices, and it was not unreasonable for HMRC to refuse to accept other evidence.

The judge agreed that the invoices did not comply with the regulations and his jurisdiction was supervisory. He had to consider the reasonableness of the decision made at the time it was made – 2 March 2018 – taking into account the information provided up to that time, not information provided later. The decision of the UT in *Boyce* was binding, and the judge rejected the taxpayer's representative's attempts to distinguish it. The appellant had failed to provide convincing alternative evidence particularised to each supply, but rather had supplied documents and data on a sporadic and generic basis, leaving it to HMRC to try to reconcile the figures with individual supplies. The judge did not consider HMRC's refusal to accept this evidence to be unreasonable.

In respect of the "export" issue, HMRC relied on Notice 725. The judge agreed with the taxpayer's representative that this was irrelevant, because the supplies were of hire – the issue was whether they fell within Sch.4A or s.7A. The company had not produced sufficient evidence to show that the hire took place in the RoI or was made to people belonging in the RoI; it was entirely possible that the hires were in the UK.

In respect of the “loan”, the burden of proof was on the trader to displace an assessment that had been raised to the best of the officer’s judgement. The person who made the payment was a customer of the company; it was an unusual amount, and it was extremely surprising for such a large amount to be loaned without any documentation or other supporting evidence at all.

The appeal was dismissed on all three issues.

First-Tier Tribunal (TC07738): *Kardi Vehicles Ltd*

5.8.3 Public Bodies

HMRC have made a number of updates to the *Government and Public Bodies Manual*, for example updating the guidance on the bodies included in the VAT refund scheme in section 33E of the VAT Act 1994 and contracted out services in relation to government departments and health authorities.

VATGPB9720, VATGPB9650

HM Treasury (HMT) has published a policy paper on potential reforms to VAT refund rules for public bodies.

Under the current VAT rules, government departments, devolved administrations, the NHS and Highways England are eligible for VAT refunds under s.41 VATA 1994. However, s.41 in its current form is unduly complex, administratively burdensome and a barrier to effective financial planning. It therefore needs reforming.

HMT is proposing to extend the scope of s.41. Broadly, two models are proposed for VAT refunds – allowing full VAT refunds or removing VAT refunds entirely. The Full Refund Model is HMT's preferred option for reform to s.41 at this stage, following initial positive feedback from across government. However, the government is mindful of the complexity of implementing the reform and welcomes views from any interested stakeholders before 19 November 2020.

www.gov.uk/government/publications/vat-and-the-public-sector-reform-to-vat-refund-rules

Up to 15 September, HMRC consulted on the draft *Value Added Tax (Refund of Tax to Museums and Galleries) (Amendment) Order 2020*. The draft legislation sets out additions and changes to the list of museums and galleries (in SI 2001/2879) that are allowed to reclaim VAT attributable to the provision of free admission, under the special VAT refund scheme in s.33A VATA 1994.

The consultation gave those museums and galleries affected by the Order the opportunity to check that the proposed changes and additions to their details are correct.

Up to 28 July, HMRC also consulted on views on draft legislation (*The Value Added Tax (Refund of Tax to the Charter Trustees for Bournemouth and the Charter Trustees for Poole) Order 2020*) that would add two bodies to the list of organisations entitled under s.33 VATA 1994 to claim a refund of VAT charged on supplies even though those supplies are not used for the purpose of their business.

SI 2020/Draft

6. ADMINISTRATION AND PENALTIES

6.1 Group registration

6.1.1 Call for evidence

The government has published a call for evidence to examine how VAT grouping provisions operate in the UK and potential changes, including on establishment and compulsory grouping.

The call for evidence is intended to gather information and views on the current UK VAT grouping provisions, and on provisions that have been adopted by other countries. The views collected through the call for evidence will inform future policy direction.

This call for evidence will examine three distinct areas of VAT grouping:

- The establishment provisions
- Compulsory VAT grouping
- Grouping eligibility criteria for businesses currently not in legislation, including limited partnerships

The government is inviting responses from businesses that use VAT grouping provisions, and other interested parties before 20 November 2020.

www.gov.uk/government/publications/vat-grouping-establishment-eligibility-and-registration-call-for-evidence

6.2 Other registration rules

6.2.1 Joint venture

The CJEU has now given its ruling in a case about the identification of the taxable person where two people entered into a joint venture in property development, but only one of them was actively involved in running the business with respect to outsiders, following A-G Kokott's opinion (July 2020 update).

The "silent partner" contributed 70% of the costs, was involved in overall decisions and took a share of profits, but was not "visible" to outsiders. The question arose of liability to output tax, and also the right of the customer to deduct input tax if the documentation did not accurately identify the taxable person making the supply.

The parties had entered into their joint venture in 2010. A parcel of agricultural land was acquired and the "active" partner obtained a construction permit in his own name. Five residential properties were constructed; the first was sold on completion in 2010; the other four were divided between the partners on termination of their joint venture agreement in 2011; the active partner sold his two properties in May 2011 and November 2012; in due course, in February 2013, he also sold one of the others, in his own name but on behalf of the silent partner, and paid him the proceeds. None of these sales was declared for VAT. The tax

authorities carried out an audit for income tax and VAT and concluded that there was a single taxable activity. The active partner appealed against assessments; he lost at all stages in the domestic courts, and questions were referred to the CJEU.

In Lithuania, a partnership is not regarded as having legal personality and is not capable of being a taxable person. The questions therefore ask whether the reference to carrying on an activity "independently" in art.9 PVD meant that the person assessed should not be regarded as liable for all the tax; and if that is the case, whether and how it should be allocated between the two under art.193; and how the exemption threshold for small enterprises should be applied in such a circumstance.

A-G Kokott analysed the first problem as the identification of the taxable person in accordance with art.9. It could be the applicant alone (according to the Lithuanian tax authorities), the partnership between the applicant and the business partner (in part, according to the Commission), the applicant and his business partner collectively (in the opinion of the referring court) or, in part at least, the business partner alone (in part, according to the Commission). The answer depended on which of them qualified for recognition as a taxable person under art.9, and if more than one did, which should be so recognised.

The question of whether a particular legal form was recognised as having personality under national law was not material to the question of whether an economic activity was being carried out in an independent manner. However, economic activity requires the respective national legal system to recognise the capacity to act (in an economic sense) in legal transactions. Only structures which are able to have rights and obligations can act in legal transactions and therefore have legal capacity. In this case, either the applicant or the business partner alone or the applicant together with his business partner could easily have that capacity by reason of the fact that they are natural persons and thus have legal capacity. However, what was unclear in this case was whether the form of cooperation between the applicant and the business partner had that capacity. If the national legal system did not recognise that form of cooperation as having legal capacity, it could not be a taxable person.

In deciding who should be liable for the tax, the A-G referred to case law precedents that confirmed that it is necessary to examine 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. In her opinion, where there are several possible taxable persons, only one taxable person can ultimately fulfil those criteria.

Referring back to the facts of the case, the A-G was confident that the applicant acted alone; everything was done in his name, and third parties would have been unaware of the existence of the silent partner. The profit share allocated to the partner did not alter the fact that the applicant had acted outwardly independently. Nor did the allocation of some of the profit to the partner under income tax law: VAT and income tax rules pursue different objectives.

Because the A-G concluded that the applicant alone was the taxable person, it followed that the turnover limit should be applied to him alone. However, in case the full court disagreed on the first conclusion, the A-G

considered the application of the turnover threshold, which is an administrative simplification for the benefit both of taxpayers and the tax authorities. In her view:

- a single taxable person, whether a natural person or a partnership (if it had capacity) would have a single threshold applied to it;
- if the two parties were regarded as separate individual taxable persons, then in the absence of abusive arrangements (of which there was no evidence here), they should each be given their own exemption limit.

The full court has now given its judgment, essentially agreeing with the A-G. On the facts as set out in the order for reference, the applicant had done everything in his own name, and he was therefore the only person who was acting in an economic capacity. The fact that the silent partner had contributed finance was irrelevant.

The full court declined to answer the second question about the turnover threshold.

CJEU (Case C-312/19): *XT, Lithuanian Republic intervening*

6.2.2 No evidence of business

In TC03242 (FTT 2014), an individual applied to register for VAT in November 2010. After some discussion, his EDR was set as 1 February 2007; a late registration penalty was raised, and then cancelled when he explained that most of his sales were of consultancy services to businesses belonging outside the UK, so there was no output tax to pay. When he submitted a claim for repayment of £25,000 of input tax for the long period from 1 February 2007 to 30 September 2011, HMRC decided that he was not carrying on a business and was not entitled to the tax. He appealed to the FTT.

The Tribunal heard evidence from the appellant and examined the documents that he produced. These did not substantiate the nature of the supplies that he made to clients, nor did they establish a link between supplies made and consideration received. It appeared that he had the trappings of a business (accounts, website, bank account), but there was insufficient evidence to show that he charged for the services that he provided. It was possible that he had exempt income. The Tribunal considered that someone who was involved in supplying taxable professional services over such a period would have been able to produce satisfactory evidence of it, such as letters from clients engaging him for specific work or copies of sales invoices for specific work completed, rather than vague “professional services provided”.

As the onus of proof was on him to satisfy the Tribunal of this precise point, his appeal was dismissed. He applied to appeal to the UT on the basis of new evidence; this was refused in 2014 on the grounds that the new evidence could not be considered on appeal by the UT, but he was told that he could apply for registration again if he could provide justification for it. He accordingly applied again; HMRC issued a certificate of registration on 22 July 2015 with the EDR backdated to 1 March 2007, but when the trader applied for repayments, HMRC ruled that the EDR should be 20 July 2012. The trader appealed.

Another FTT hearing took place in February 2019, not apparently reported, in which it was further confirmed that he was not entitled to be registered from 1 March 2007 to 20 July 2012; no significant new evidence had been presented since the 2014 FTT decision. The appellant succeeded on a second issue, that certain personal services he provided in the UK to overseas clients constituted an ancillary element of a composite supply.

The individual appealed against the registration decision to the UT. HMRC argued that a person could not be registered twice for the same period, and the cancellation of registration following the 2014 FTT therefore ruled out backdating to 2007; the FTT considered that the cancellation of the registration meant that there would be no question of double registration, and it was therefore possible for the trader to apply again. It accepted that he was carrying on an advisory business, mainly to overseas customers, and that many of the documents that would have supported his input tax claims had been destroyed in a fire; his inability to obtain copy invoices or similar alternative documentation was "much more difficult to understand". Indeed, the reason for refusing the input tax claim was disputed between the parties and had to be settled by the UT on appeal.

The appeal was made on the grounds that the FTT had erred in law in concluding that no significant new evidence had been produced, and effectively it was unduly influenced in following the 2014 decision in spite of significant differences in the presentation of the case. The UT agreed with this in one particular detail: it was clear that there was significant new material in the appellant's witness statement, and it was therefore not correct that "no new material" had been provided. As the FTT decision appeared to be based on the necessity to follow the 2014 decision because nothing had changed, that was an error of law that required the decision to be set aside. The UT chose to remake the decision, and came to the conclusion that the 2012 EDR was still correct: there was new evidence, but it did not provide compelling or specific confirmation that there were taxable supplies before 2012. The appeal was therefore rejected again.

The appellant also appealed against HMRC's decision to reduce his input tax claims for periods 08/15, 11/15 and 03/16 by substantial amounts. The FTT had found in his favour on the ground that the personal services he rendered in the UK were part of a composite supply that was in principle taxable (although outside the scope as provided to foreign customers). That conclusion was not disputed in the UT by HMRC; however, they sought at a very late stage to add a ground to their respondents' notice arguing that the FTT had failed to consider all of the issues before it – there were other reasons for disallowing the input tax, including that many invoices were addressed to a third party, and there was a lack of evidence connecting the supplies to the appellant's business.

The Tribunal applied the principles of *Martland* and concluded that there was no good reason for HMRC's significant delay in attempting to bring in this new ground of appeal. Their application was therefore rejected; however, the UT considered that it was nevertheless necessary to consider the deductibility of the input tax, because HMRC had continued to refuse to repay it, and it was therefore part of the appeal.

The UT agreed with HMRC that invoices addressed to third parties appeared to represent supplies that were not made to the appellant, and the input tax could not therefore be claimed by him. There was also insufficient evidence that certain hotel bills were connected with his business. However, invoices relating to property valuations, addressed to the appellant, could credibly be connected to his business of advising his clients on suitable investment properties, and this input tax should be allowed.

The appeal was therefore successful to a very limited extent. The same man was involved in three other FTT hearings, TC04898 in January 2016, TC05531 in October 2016 and another in February 2019 in relation to his income tax and Class 4 NIC liabilities; these concerned various disputes over losses and reliefs, and resulted in confirmation of assessments approaching £150,000. The 2016 decisions were considered by the present UT as they were offered in evidence by the appellant to support his contention that he had been in business before 2012. The judges did not agree that this was a compelling conclusion.

Upper Tribunal: *Andrew Adelekun v HMRC*

6.2.3 Late registration

A KFC franchise was operated by a company W in Manchester. It was not registered for VAT. In 2016, the company transferred its business to another company N, which also operated without registering for VAT. A few months later, HMRC decided that the new company should have been registered; on further investigation, they concluded that the predecessor should also have been registered. Various decisions were issued and appealed:

- W should have been registered from 1 May 2013 to 31 May 2016, and was assessed to £52,380 in VAT on "best judgement";
- a personal liability notice was issued to the sole director of W for 63% of PLR;
- N was registered with effect from 6 June 2016, after a number of procedural irregularities about an original decision to register from 1 June, but no output tax assessment had been issued;
- nevertheless a late registration penalty was charged on N, but this apparently was not appealed.

W argued that the extrapolation back to its business from N's business was illogical and incorrect, and the technical problems with the decision to register N invalidated the decision to register W.

N argued that registering it from the date of acquisition of the business depended on W being registered at that time, and the decision to register W post-dated the issue of the registration certificate to N. N protested a number of other technical irregularities and criticisms of the method of extrapolation.

Judge McNall reviewed the evidence and the grounds of appeal, and found the grounds to be misconceived. N did not have a working till for several months, and without any evidence of what its turnover actually was, it would struggle to displace a logical best judgement assessment.

The judge was satisfied that the assessment met that standard. Similar considerations applied to the other decisions. All the appeals were dismissed.

First-Tier Tribunal (TC07801): *Withington KFC Services Ltd and Another*

6.2.4 Updated guidance

HMRC have updated the *Registration Manual* section on transfers of going concerns and the conditions for reallocation of a VAT registration number, adding that the transferor must have no VAT debt.

VATREG30100

6.2.5 Registration with zero turnover

The Association of Taxation Technicians (ATT) raised concerns with HMRC regarding applications for VAT registration being automatically refused where the business indicates in their application that they will be making little or no taxable supplies in the next 12 months.

In response, HMRC stated that applications for VAT registration will be rejected in some circumstances where there is a likelihood of zero turnover for the next 12 months. Where an application has been rejected, and where the business believes this was due to entering zero estimated taxable turnover for the next 12 months on the VAT1 (or in the online application), HMRC suggest that the business should email evidence to substantiate its eligibility to register to HMRC's email address for new VAT registrations (vrs.newregistrations@hmrc.gov.uk). The VAT Registration team will then review the original application and process the application accordingly.

www.att.org.uk/technical/news/vat-registration-intending-traders-—-hmrc-update

6.3 Payments and returns

6.3.1 No interest or surcharges

The Finance Act 2008, Section 135 (Coronavirus) Order 2020 gives effect to the intention that no interest or surcharges will be charged on income tax or VAT payments deferred because of the coronavirus (COVID-19) pandemic. The Order is made in exercise of the powers conferred in s.135 FA 2008. That section provides that, in the case of a disaster or emergency specified by the Treasury as having national significance, no interest or surcharges will be charged where HMRC have agreed to defer payments in respect of specified liabilities under an enactment or contract settlement.

SI 2020/934

6.3.2 Deferral of VAT payments

HMRC have updated their guidance to reflect the fact that the facility for deferring current VAT payments and payments on account ended on 30

June. Presumably businesses severely affected by a loss of trade will not have significant current VAT liabilities in any case, but will be more concerned with meeting the liabilities that were deferred from March to June. Over half a million businesses deferred VAT payments under the measures announced in the spring – described in the Winter Economy Plan as "a cash injection of £30 billion into the UK economy when it needed it most."

www.gov.uk/government/collections/hmrc-coronavirus-covid-19-statistics#vat-payments-deferral-scheme

The Chancellor announced that businesses which deferred VAT due in March to June 2020 will have the option to spread their payments over the financial year 2021/22, rather than paying in full at the end of March 2021. Businesses will be able to choose to make 11 equal instalments over 2021/22. Businesses will need to opt in to the New Payment Scheme, but all which took advantage of the VAT deferral are eligible. HMRC will put in place an opt-in process in early 2021. The curious number of payments – 11 rather than 12 – has not yet been explained, but will presumably become clear in due course.

www.gov.uk/government/publications/winter-economy-plan

6.4 Repayment claims

6.4.1 Historic claims

Three motor traders (K, M and B) made *Elida Gibbs* and *Italian Republic* claims for repayment of VAT overpaid between April 1973 and December 1996. They were all part of the same VAT group between 1993 and 1999, but two of them had made separate claims before 31 March 2009 for the VAT, each claiming the whole amount in the hope that one of the two would be a valid claim. They now sought to amend their claims to reflect decisions in other cases; Judge Jonathan Cannan had to consider whether, in essence, this was a new claim (and therefore out of time) or merely an amendment of an existing claim (and therefore potentially valid).

HMRC had had different reasons for rejecting the original claims in 2009. B's claim had been rejected because HMRC had originally taken the view that only the "real world supplier" could make a claim once a VAT group had been dissolved. Some of K's claim had been allowed, but it was rejected to the extent that it related to VAT paid by other group companies. The company argued that the right to claim had been validly transferred to it. M had been dissolved before March 2009, but restored to the register afterwards. HMRC refused its claim on the basis that it had not existed at the time that the claim ought to have been made. However, in 2013 some VAT was repaid to M; M continued to appeal against the refusal of the rest of its claim.

HMRC's view was that the claims had been settled, as far as they were valid, and it was not open to the companies to continue to pursue them. The main item of dispute was in the *Nordania Finans* adjustments made to the *Italian Republic* claims. If the companies had not been satisfied with the amounts repaid earlier, they should have appealed at the time.

The companies argued that they had made single claims for the various periods under appeal: they comprised a series of *Elida Gibbs* claims, and a series of *Italian Republic* claims, but the two were so closely linked that they could not be dealt with or settled by HMRC in isolation from each other. They contended that, because the *Elida Gibbs* claims were still open, they could continue to argue about the *Italian Republic* claims.

The judge examined the history of the claims and concluded that the claims had been separate – two claims for each return period. They arose from separate matters – the receipt of rebates and the sale of demonstrator vehicles. The Upper Tribunal in *Vodafone Group Services Ltd* held that the focus had to be on the supplies that were the basis of the claim, not simply the fact that a claim had been made, or the amount claimed. For that reason, the judge considered that the *Italian Republic* claims were no longer open and the companies were not entitled to amend them. The application was refused.

First-Tier Tribunal (TC07712): *Kendrick Kar Sales Ltd and others*

6.4.2 Policy on historic reclaims

HMRC have updated the *Refunds Manual* to take account of the Court of Session judgment in *NHS Lothian Health Board*. HMRC suggest that "each claim must be considered on its individual merits" but a claim may be rejected where "witness evidence is on general industry practice rather than the specific supplies made by the claimant; and it is not agreed that input tax has ever been incurred, or if it was incurred, the extent to which it has already been recovered is unclear."

The following comments on the principle of effectiveness are informative:

It's possible that taxpayers may incorrectly cite NHS Lothian in support of their position that the EU principle of effectiveness means that claims cannot be rejected because of a lack of evidence.

The Court's comments on effectiveness were made in the context of the FTT finding that there had been an overpayment of VAT and it was the fault of the state that there were deficiencies in evidence. (This is a reference to the Scottish Office's policy of not seeking to recover VAT when NHS Trusts were under its control).

The principle of effectiveness means that where a right to repayment is proven then national legal systems cannot make it impossible or excessively difficult for a taxpayer to exercise that right. However that does not in itself assist a taxpayer in crossing the first hurdle, which is proving on a balance of probabilities that Output Tax was overpaid or Input Tax incurred and not recovered.

VRM9300

6.5 Timing issues

Nothing to report.

6.6 Records

6.6.1 The future is digital

HMRC have published a report setting out a 10-year strategy "to build a trusted, modern and digital tax administration system". The government's vision for the future of tax administration in the UK is designed to improve its resilience, effectiveness and support for taxpayers. As part of this vision, the document sets out a roadmap for the extension of Making Tax Digital:

- from April 2022, MTD will apply to all VAT-registered business for their VAT obligations (extending to those who are voluntarily registered);
- from 6 April 2023, businesses and landlords with business income over £10,000 per annum which are liable for income tax will need to keep digital records and use software to update HMRC quarterly through MTD (the original proposal for the first introduction of MTD, which was supposed to be implemented a year before the VAT system but was deferred).

Later in 2020, the Government will consult on the design of the MTD system for corporation tax.

www.gov.uk/government/publications/tax-administration-strategy

HMRC's website guidance has been updated to refer to the future changes.

www.gov.uk/guidance/help-and-support-for-making-tax-digital

6.6.2 MTD guidance

HMRC have updated the guidance *Making Tax Digital for VAT as an agent: step by step* to provide more information on how agents can ask new clients to authorise them to digitally file their VAT returns.

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

6.6.3 Article

In an article in *Taxation*, Allison Plager examines the outcome of an Ipsos MORI research report commissioned by HMRC in early 2020 to find out why businesses were not complying with their MTD obligations. The results suggest that HMRC need to communicate better: small businesses have not well understood their obligations, nor how to comply with them. "Overwhelmingly, the MTD message is misunderstood among small businesses. Many perceive it as a big and expensive task that brings no clear benefit either to themselves or HMRC."

Taxation, 20 August 2020

6.6.4 Correction of errors

A taxable person was the subject of an inspection by the tax authorities. Having identified errors with regard to a given transaction in which that taxable person acted as supplier, the tax authorities issued a tax assessment requesting the taxable person to pay additional VAT. The

taxable person complied with the tax assessment and paid the additional VAT requested.

Subsequently, however, new facts came to light which triggered a different tax regime (the reverse charge mechanism) with regard to the transaction at issue. The Romanian tax authorities refused to allow the taxable person to correct the relevant invoices, and thus, in effect, denied the taxable person the right to a tax adjustment, because the invoices related to transactions carried out during a period which was the subject of a tax inspection, and the resulting tax assessment was not challenged by the taxable person at that time. The taxpayer appealed, and questions were referred to the CJEU.

The original assessment (March 2014) was based on a finding that the company could not produce the required documentation to show that despatches had been made to a customer in Germany (October 2013). The customer confirmed to the appellant that the goods had not left Romania, and asked for corrected invoices identifying the customer's tax representative in that country. These were issued by the appellant in relation to 180 transactions; as failed despatches they were subject to output tax at 24%; however as domestic transactions they were subject to the reverse charge in accordance with art.199a PVD, which Romania was authorised to apply to transactions in certain cereals, including rapeseed.

The company therefore deducted an adjustment in relation to these corrective invoices from the VAT due for its current return period (March 2014). The claim for a repayment of VAT led to another tax audit (November 2016 to February 2017), and a further assessment was issued (February 2017), which was appealed.

A-G Bobek considered that the principles of fiscal neutrality, effectiveness and proportionality precluded the actions of the tax authority in this case. According to the law in force at the time, the customer was liable for the VAT on these transactions. The first assessment was therefore incorrect.

Case law precedent shows that a taxable person must be able to correct errors and to recover tax incorrectly paid. The Romanian authorities argued that this did not apply here because the trader had failed to appeal against the first assessment within the appropriate time limit, and because the trader had not acted in good faith.

The A-G accepted that an assessment that has been raised and has become final cannot be reopened. That is in accordance with the principle of legal certainty. However, in this case the assessment was correctly raised, based on the invoices that had been issued by the supplier at the time; the customer's request for revised invoices introduced new facts that had not previously been taken into account. As the company had already complied with the tax assessment, correction through the tax return was the most obvious mechanism for adjusting the VAT improperly invoiced.

The A-G considered that the imposition of a time limit in this way when new facts have come to light would elevate legal certainty over fiscal neutrality and effectiveness to an unacceptable degree. In general, a national rule stating that what has already been reviewed (administratively or judicially) is not to be reopened is sound and proper. However, that principle can logically only be applied with regard to those matters, of law

or fact, that were indeed the subject matter of a review. By contrast, the effect of being time-barred cannot extend to new elements that were not and could not have been subject to any such review, because they were not present at the relevant time.

The A-G went on to consider the allegations of bad faith, which included suggestions that the goods were the subject of suspicious transactions by the customer. It seems that the Romanian authorities never attempted to collect the tax from the customer, and could provide no explanation for this failure. The tax authorities can only invoke a lack of good faith if they expressly allege negligent behaviour on the part of the taxable person, explain the reasons in law and fact that support that view, and, where appropriate, submit evidence that corroborates those allegations. That was not present in this case. Similar considerations applied to an allegation of abuse of rights.

The suspicious transactions after the event could only be relevant if the authorities had evidence that the company knew, or had the means of knowing, that it was party to a fraudulent scheme. Once again, that required evidence, and the Romanian authorities produced none. At the hearing, they made some allegations of inadequate bookkeeping, but the A-G considered that was arguably minor and purely formal – it could not justify a complete loss of the right to adjust and obtain a refund.

The A-G recommended that the court should find that the Romanian authorities' actions were not in accordance with the PVD: a Member State can refuse the tax adjustment and the refund of the tax unduly paid by the supplier only where the tax authorities can, based on objective factors, establish to the requisite legal standard that the correction of the invoices triggering the application of the reverse charge mechanism was made in bad faith, constituted an abuse of rights, or was connected with a tax fraud of which the supplier was aware or should have been aware. It is for the referring court to ascertain whether that is the case in the main proceedings.

The full court has now given its judgment, which essentially agrees with the A-G's opinion in all material respects.

CJEU (Case C-835/18): *SC Terracult SRL v Romanian Tax Authorities*

6.7 Assessments

6.7.1 Right to assess "what was not input tax"

In TC07158 (July 2019 update), a NHS Trust claimed £115,000 of VAT incurred on new IT equipment. HMRC raised an assessment under s.73 VATA 1994 to recover this, ruling that the trust was not entitled to it under s.41. The Tribunal had to consider a preliminary issue of whether a s.73 assessment was valid in the context of VAT that had been claimed under s.41.

HMRC's position was that s.73 was clearly applicable to any amounts of VAT wrongly recovered by the appellant and there was nothing in the EU or UK VAT systems, the case law, or Parliament's presumed intentions,

that suggested otherwise. The matter came before Judge Mosedale, who had to consider the EU VAT system and the UK VAT system, including relevant case law, and Parliament's presumed intentions as represented by the taxpayer.

It was true that VAT claimed under s.41 was not "input tax" and was not within the normal rules of EU VAT. The UK's scheme for refunds was not authorised by the Directive, but neither was it forbidden. The judge agreed with HMRC that the answer to the question had to lie within the scope of s.73 itself. The words of that section are quite clear: "where there has been paid or credited to any person an amount of VAT that ought not to have been paid or credited", HMRC had the power to raise an assessment. Although the Trust attempted to make something of the special nature of VAT under s.41, the judge was satisfied that it fell squarely within s.73.

She went on to consider arguments about Parliament's intentions, and concluded "none of the reasons put forward by the appellant for suggesting that I should not interpret s.73 literally support its case. I consider that I should interpret s.73 literally as that is likely to be Parliament's intent."

The preliminary issue was decided in favour of HMRC, and the substantive question of whether the VAT had been properly claimed would have to be considered by the Tribunal on another day.

The Trust appealed to the Upper Tribunal. The UT provides the following rationale for the right to claim under s.41:

Under the EU's Principal VAT Directive, only taxable persons have a right to recover VAT which they incur. A public body such as a Government department, acting in its capacity as a public body, does not have that right (subject to certain exceptions in the Directive which are not relevant here) because it is not acting as a taxable person.

This might cause public bodies to undertake activities in-house which in business terms could most sensibly have been outsourced, simply to avoid the VAT charged by external contractors. In order to avoid such a bias, the UK, in common with some EU Member States, has enacted a regime which permits the reclaim of some such VAT on certain terms. The Directive does not provide for this, but nor does it prohibit it.

The Trust's counsel argued that the FTT had erred in not accepting that s.41 VAT was not within s.73 and could not be assessed under it, as it was not input tax; s.73 only applied to taxable persons; and the FTT also treated the interpretation of s.73 as essentially a question of semantics, when it should have considered the structure of the VAT system in the EU context (as there is no separate UK VAT system). HMRC responded that the FTT had been correct to apply a plain literal reading of s.73, and the VATA was the only relevant "system" to be applied.

The UT agreed with HMRC. The claim under s.41 was for "VAT charged to" the claimant Trust; s.73 referred only to assessment of incorrect amounts of VAT refunded. There was nothing in s.73 to restrict its application to taxable persons only. There is a distinction between taxable persons and "persons" in general in s.3 VATA; s.73 only refers to "persons", not "taxable persons". Where the legislation intends to refer to a narrower class of persons, it does so.

A number of other arguments raised by counsel for the Trust were considered and rejected. There was no distinction between "the EU system" and "the UK system". Although s.41 dealt with an unusual situation, it was not unique, and attempts to treat it as exceptional still did not have any bearing on the plain words of s.73.

The appeal was dismissed.

Upper Tribunal: *Milton Keynes Hospitals NHS Foundation Trust v HMRC*

6.7.2 Time limits

An individual appealed against assessments covering periods from 12/00 to 09/16 totalling £259,845, together with penalties of £82,198. The basis of the assessments was that the trader had deliberately overclaimed input tax on his returns, and the assessments were raised to best judgement.

The trader purchased goods from abroad (mainly India) and sold them for cash to market traders. When he was visited for the first time in September 2016, the officer discovered that his records were rudimentary; he appeared to have no understanding of the import procedure, and had "assumed" that he had paid VAT on imports when he had only one C79 certificate. The officer concluded that there had been deliberate overclaims going back to the first registration, and raised the assessments on the basis of a 20-year time limit. These were upheld on review.

The judge reviewed the methodology used to reduce the 2016 input tax claims, and approved the extrapolation of the result back to 2000. The assessment was made to best judgement. He rejected the appellant's suggestion that the visiting officer had decided in advance to penalise him "as much as possible as soon as she entered his premises for the visit".

The trader's inability to provide accounting evidence rendered him unable to displace a best judgement assessment. The figures he did provide were not credible: his VAT returns showed that his expenses exceeded his sales in the period 09/00 to 09/16 by £1,087,710. The total inputs were £1,775,871 whereas the total outputs were £688,161, and the turnover shown for VAT did not agree with the lower figures in his self-assessment income tax returns.

The judge went on to consider the question of whether the conduct was "deliberate", which would validate the extended time limit for assessment. He cited the direct tax precedent of *Tooth* (CA 2019) in which Floyd LJ said that the time limit rule contained two stages: the FTT had considered whether the taxpayer deliberately set out to understate the tax, but the law required a consideration of whether the inaccuracy was deliberate, and then whether it brought about an understatement of tax. This had been considered to apply to s.77(4) VATA by the FTT in *Leach* (TC07180). This was not a binding precedent in the present case, but the judge agreed with the reasoning; the conclusion was that it was only necessary for HMRC to show that the taxpayer knew that he was not using the correct numbers, rather than showing that he intended to mislead them. The judge was satisfied that this was the case. The inaccuracies arose out of basic VAT law rather than any technicalities or complexities, and the Tribunal did not find it credible that the taxpayer was unaware that he was entering figures in his returns that he was not entitled to. The appeal against the assessments was dismissed.

Turning to the penalties, the judge noted that the *Tooth* definition of "deliberate" is not applicable in the same way to a penalty, as discussed in *Auxilium Project Management* (TC05024). The approach in that case has since been adopted in many other penalty cases: "'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." Once again, the Tribunal was satisfied that the test was met. Disclosure was prompted by the visit; full mitigation had been given for cooperation and disclosure. The penalties were also confirmed.

First-Tier Tribunal (TC07800): *Mirza Shaharyar Baig*

6.8 Penalties and appeals

6.8.1 Default surcharge

A company appealed against a 5% surcharge of £4,090 for its 04/19 period. It had entered the DS regime in 10/18 when its return was submitted late. It appears that the DD that had been in force since 2010 was cancelled; there was a dispute about whether this had been done by HMRC, but it was not resolved. The problem was that the company did not set up a replacement DD successfully – the managing director said that she had done so and "assumed" it would be in place, but she apparently did not check, because no DD was in place for the 04/19 payment. There was no evidence of the actual completion of a DD application.

She also claimed that she had rung to discuss payment by BACS after she noticed that the DD had not been collected, and said that the officer had told her no surcharge would be levied if she paid that day. HMRC produced a transcript of the call showing that no such assurance had been given; on the contrary, she was told that a 5% surcharge would follow, as the payment was already late.

The judge considered that the actions of the trader did not meet the standard of a reasonable excuse, and dismissed the appeal.

The company has appeared in the Tribunal twice before – TC03250 concerned zero-rating of vehicles adapted for disabled users (the company won) and TC04332 concerned an application for costs in relation to the earlier appeal (the application was refused).

First-Tier Tribunal (TC07824): *Concept Multi-Car Ltd*

6.8.2 Penalties

In TC05508 (late 2016), a company was denied £12.8m of input tax claimed in 2006 on MTIC grounds. The FTT found against it in respect of one return period, and the company withdrew appeals in respect of two more. The Tribunal had concluded that the director actually knew of the connection to fraud, and HMRC subsequently issued a "deliberate conduct" penalty at 100% of the tax. This was issued to the company, but with a personal liability notice to the director at the same time.

The director appealed and made some applications to a directions hearing. These included an argument that the personal liability notice was an abuse of process, because it was a criminal penalty for the purpose of the Convention on Human Rights and the procedure for appealing it (the FTT) denied the "defendant" rights such as trial by jury, and as he had not secured legal aid, representation.

Judge Berner did not accept that the appellant would be denied a fair trial, and confirmed that the civil standard of proof would apply. It would be an abuse of process for the appellant to dispute facts that had been found by the Tribunal in the one case that had been decided, but he should be free to dispute facts in relation to the later periods for which the appeals had been withdrawn and not heard. The Tribunal's decision was relevant and should be admitted in evidence.

The director appealed against the FTT directions to the UT. By the time of the hearing on 8 June 2020, he had obtained legal aid to pursue his appeal. The three issues to be determined were:

- whether it was an abuse of process to proceed by way of PLN rather than a jury trial;
- whether the standard of proof should be civil or criminal;
- whether the decision in the FTT case (*Intekx Ltd* TC03416) should be admitted in evidence.

The UT considered in some detail the difference between "deliberate behaviour" and criminal conduct. Although at first sight it appears that "knowingly claiming input tax that is connected with a fraudulent tax loss" appears to be an allegation of fraud, the judge held that it was not so – it was a knowing claim to input tax that the company was not entitled to, but it was not a conspiracy to cheat the revenue, nor was it being "knowingly concerned in the fraudulent evasion of VAT". There was therefore no abuse of process in pursuing the PLN.

The judge went on to consider in equal detail the difference between the civil and criminal standards of proof, and circumstances in which the civil standard should be "upgraded" to something equivalent to the criminal standard. In spite of extensive arguments put forward by the appellant's counsel, the judge was not satisfied that any of these applied; the normal civil standard of the balance of probabilities should be followed, largely for the reasons set out in the FTT decision.

The decision to admit the 2014 FTT decision against the company as evidence was a case management decision with which the UT should be slow to interfere. That ground of appeal was also dismissed.

Upper Tribunal: *Lindsay Hackett v HMRC*

In TC06892 (early 2019), a trader had claimed input tax on transactions in his 12/05, 03/06 and 06/06 returns. £22m in respect of 12/05 was repaid in tranches; a similar amount for the two following periods was never repaid. HMRC later refused repayment on *Kittel* grounds. The trader appealed, but the appeals were eventually struck out in 2015 for the appellant's failure to comply with an unless order. Applications to reinstate the appeals were refused, exhausting the trader's rights by 2 November 2017 when the Upper Tribunal confirmed the refusal. In August 2017, HMRC issued misdeclaration penalty assessments on the

inaccuracies in the 03/06 returns. The total in penalties was just over £2.5m. The trader appealed against the penalties, and HMRC applied to have the appeal struck out.

The appellant contended that HMRC's delayed repayment of the 12/05 reclaim was relevant to the misdeclaration penalties. He had applied for a repayment supplement in 2006; this was refused and the refusal was appealed. In August 2017, HMRC conceded that appeal. However, they told the appellant that the supplement would be offset against the misdeclaration penalties that he owed.

Judge Mosedale made a number of decisions. First, she allowed the appeal to proceed even though it had been made late. She then considered an application for summarily allowing the appeal on the following four points of law:

(a) the assessment was invalid because (i) it referred (allegedly) to the wrong assessing provision (VATA 1994 s.63 rather than the technically correct s.76) and/or (ii) because the appellant had not been given a chance to state his defence before he was assessed;

(b) The provision giving liability was repealed without saving;

(c) The assessment was out of time.

The judge dismissed the argument about referring to s.63 rather than s.76. There was no requirement that an assessment should refer to the section under which it was raised. She also rejected the argument that s.63 required HMRC to consider whether there was a reasonable excuse before they issued a penalty assessment – in her view, the literal meaning of the words could not support that interpretation.

The appellant's point about the repeal of s.63 depended on the fact that the replacement of the penalty provisions in 2009 specifically preserved HMRC's right to assess earlier periods under s.60, but not s.63. The judge did not agree: there was a different reason for that saving provision, and it was the intention of Parliament that s.63 would continue to be available in respect of misdeclarations arising before the change of the law.

The relevant time limit for the penalty assessment was in s.77(2): "subject to subsection (5) below, an assessment under s.76 of an amount due by way of any penalty….referred to in subsection (3) …of that section be made at any time before the expiry of the period of 2 years beginning with the time when the amount of VAT due for the prescribed accounting period concerned has been finally determined." HMRC argued that this 2 year time limit only started to run on 2 November 2017, when the appeal rights had been exhausted. The taxpayer argued that s.77(2) only applied to assessments, not to repayment claims, because it referred to "determination of VAT due".

Judge Mosedale agreed with HMRC on the time limit point – it had to run from the determination of the appeal, not from the return period. That could either be the date the appeal was struck out (September 2015) or the final refusal of reinstatement (November 2017), but in either case, an assessment raised in August 2017 was within 2 years of it. She rejected the distinction between assessments and repayment claims: "the VAT due for the period" could be VAT due in either direction.

The judge went on to consider whether she should require HMRC to pay the repayment supplement. She concluded that she had no jurisdiction to consider whether they were entitled to set off the supplement against the penalty. She had no need to consider whether the penalty itself should be paid upfront, because that was clearly not required by the law. The only issue was whether HMRC were entitled to exercise a right of offset, and that was a matter for judicial review, not for the FTT.

The appellant also argued that the penalties were criminal in nature for the purposes of the European Convention on Human Rights. She agreed (indeed, HMRC had conceded the point): they were punitive and deterrent in nature, and could not be described as a minor matter. She did not accept that the set off amounted to a presumption of guilt, nor was his right to a fair trial breached.

The trader also made an application to amend his grounds of appeal against the penalty. HMRC applied to have all the amendments struck out. The judge decided that they should only be struck out if they had no reasonable prospect of success, and on that basis, the only ground that survived was the argument that the penalty was disproportionate because of its absolute size. In an earlier case, Judge Mosedale had held that a percentage penalty could never be disproportionate, because a larger error posed a larger risk to the public purse; but she accepted that the Upper Tribunal had identified the lack of an absolute maximum as the one feature of the default surcharge regime that was arguably disproportionate, so she accepted that this was at least a possible ground of appeal.

In all other respects, the appeal was dismissed.

The individual appealed to the Upper Tribunal. arguing six grounds. The first three essentially argued that a misdeclaration penalty could only be levied after the taxpayer had been given the opportunity to present a reasonable excuse. The fourth was about HMRC's set-off of the supplement against the penalty, where the FTT had concluded it had no jurisdiction to interfere. The fifth attacked the penalty under the ECHR; and the last was simply that the FTT should not have struck out the penalty appeal.

The first five grounds were considered in detail, and the decisions of the FTT confirmed in each case. In relation to the sixth ground, the UT decided that the FTT decision contained two errors of law in considering that allowing the appeal to proceed would be an abuse of process. The FTT had adopted too narrow an approach in rejecting the argument that HMRC's failure to notify a misdeclaration penalty before the strike out of the *Kittel* appeals was relevant in deciding whether he should be allowed now to plead reasonable excuse. HMRC argued that it was unlikely that the individual's decision to abandon an appeal about £22m would have been affected by knowledge of a possible penalty of £2m; however, the UT said that was not a matter for a strike-out hearing but for a full hearing.

The FTT had also considered it an abuse of process that the individual now claimed that the *Kittel* appeals had been abandoned because of lack of funds, when he had not done so in the reinstatement hearings. The two matters were separate from each other, and it was not correct to insist that he should have raised the issue earlier just because he could have done.

The UT allowed the appeal against the strike-out decision and referred it back to the FTT for case management directions to progress towards a substantive hearing.

Upper Tribunal: *Dhalomal Kishore v HMRC*

A trader appealed against an assessment for underdeclared takings for periods from 06/11 to 06/16. In TC07566, the penalties were reduced from the "deliberate" scale to "careless". His new representatives then applied to appeal to the Upper Tribunal on the basis that "non-deliberate" behaviour did not justify the extended time limit assessments, so some of the periods were out of time (and the related penalties should also be removed).

The original FTT judge (Nigel Popplewell) was asked to review the decision in the light of this argument. He asked HMRC for their views, and they did not object to excluding the periods before 12/12. This reduced the assessment from £36,585 to £22,120. The judge effectively rewrote the earlier decision with additional paragraphs inserted in relation to the time limits, and recalculated the amounts. The penalty was confirmed at a percentage of 15%, amounting to £3,318.

First-Tier Tribunal (TC/2017/04474): *Ansar Ali t/a Indian Voojan*

6.8.3 Late appeals

A decision reached in a video hearing is a reminder that objecting to a decision should not be delayed while further details are obtained – it is necessary to submit an appeal to the Tribunal within the time limits. The substantive dispute concerned disallowance of input tax on certain ferry tickets. The trader's accountants appear to have tried to obtain more information about HMRC's position before submitting an appeal; HMRC were slow in replying to the first enquiry and did not reply at all to another one.

In the hearing, the trader's representative argued that the Tribunal should exercise its discretion to allow a late appeal because of HMRC's delays and because the trader did not speak English and therefore had to have correspondence translated for him. The accountants argued that they could not appeal against a decision unless and until they understood the basis for it. A review had been requested but not completed; eventually the appeal was submitted to the Tribunal after more than 45 days had elapsed, which triggers the automatic determination of a review.

Judge Anne Fairpo applied the criteria from *Martland* and *Denton*:

- establish the length of the delay – in this case, about a year and a half, which was substantial;
- consider the reasons for the delay – the judge did not consider that the reasons given were good ones;
- consider all the circumstances of the case.

There was nothing in the circumstances of the case to warrant a departure from the basic principle that the deadlines should be adhered to. This would deprive the trader of the opportunity to object to assessments and penalties, but that would always be the case and therefore did not attract much weight.

The application for permission to make a late appeal was refused.

First-Tier Tribunal (TC07778): *Andriy Kondratenko*

A company applied for permission to make a late appeal against a decision letter of 22 May 2019. This confirmed a decision to refuse an input tax claim of £569,677 on *Kittel* grounds. The appeal was lodged on 28 June 2019, 7 days late. On the 30-day deadline, the company's representative had sent an e-mail to HMRC giving the contact details of the fraudulent supplier, and asking them to stay proceedings against the company until they had investigated the person carrying out the fraud. HMRC responded to this on 26 June, noting the contents but stating that it was still necessary to appeal to the Tribunal, and the company was now late. HMRC subsequently lodged a notice of objection to the late appeal application on 23 August (after being notified of the appeal by the Tribunal on 9 July).

Judge Tony Beare applied the *Martland* and *Data Select* criteria. He considered a delay of 7 days to be neither serious nor significant. The reasons were mistaken – with hindsight, the appellants should have filed their appeal at the same time as helping HMRC with their investigation of the fraudster – but, in the circumstances, they were understandable. The company was attempting to avoid the costs of litigation for both parties. Taking everything into account, the prejudice to HMRC would be small, and the prejudice to the company would be very large. The judge gave permission for the appeal to go ahead.

He commented that he had not taken into account the delay of HMRC in communicating their objection to the application: that was not subject to a time limit and had not caused any delay in the proceedings. However, he commented that "it ill behoves" HMRC to object to a 7-day delay when they then take 58 days from the trader's request for an extension and 45 days from the Tribunal's notification of the appeal, without explanation, to object to it.

First-Tier Tribunal (TC07802): *Snapcrest Ltd*

6.8.4 Strike-out

A company appealed against assessments to £1.7m of output tax on the basis that there was insufficient evidence to support zero-rating of export of vehicles in periods from 01/16 to 06/17, and also to deny input tax claimed on various purchased and imported vehicles amounting to £310,000.

The appeal had been through a number of disputes about procedure, with HMRC objecting to the grounds of appeal as vague and having no prospect of success, and various attempts to agree case management directions that were disrupted by the retirement of the assessing officer and the pandemic. The Tribunal heard an application for strike-out by HMRC by video in August 2020.

The company had abandoned its original grounds of appeal (which were that the sales qualified for zero-rating) and now sought to challenge the "best judgement" underlying the assessments. Judge John Brooks considered precedents on allowing such a change to grounds of appeal and decided that, on balance, the length of the delay and the prejudice to HMRC outweighed any other considerations. Given that the original

grounds of appeal had been negated by the company itself, it stood no reasonable prospect of success. HMRC's strike-out application was granted.

First-Tier Tribunal (TC07843): *GB Fleet Hire Ltd*

BT appealed against the refusal of a *Fleming* claim made on 30 March 2009 for VAT accounted for on supplies made from 1 January 1978 to 31 March 1989. The basis of the claim related to bad debt relief. In 2014, the Court of Appeal held that the *Fleming* window did not apply to bad debt relief claims of this kind, because of differences in the way the time limits for capping historical claims operated.

Even so, BT maintained that it would be necessary for a Tribunal to determine various facts in order to apply the CA ruling and settle the appeal. HMRC considered that the appeal had no reasonable prospect of success, and applied to have the appeal struck out. Hearings for this application were held in July 2017 and February 2019 before Judge Harriet Morgan; the decision was only released on 29 June 2020.

Not surprisingly, for such a long-running dispute, the decision involves a detailed examination of numerous legal principles that are of relatively limited application. In summary, the judge concluded that all the points that BT wanted to argue further in the Tribunal had already been conclusively decided by the CA; to allow the case to go further would be an abuse of process. After 232 paragraphs of legal reasoning, the judge ordered the appeal to be struck out.

First-Tier Tribunal (TC07762): *British Telecommunications plc*

6.8.5 Hardship

HMRC assessed a takeaway owner to £48,011 of VAT undeclared for the period from 1 July 2014 to 30 April 2017. The trader had not submitted a VAT return, so the Tribunal had no jurisdiction to hear an appeal. Judge Anne Redston noted that both parties had treated the present hearing as a hardship application, even though that was not possible without a valid appeal (which would have required a return). She noted that an appeal should not be struck out under Rule 8(2) without first allowing the appellant to make representations under Rule 8(4).

On the basis of HMRC's bundle, the judge found a number of facts. The trader had been registered for VAT from 29 July 2012, but deregistered at the end of May 2014 on the basis that her turnover had fallen below the threshold. A test purchase in October 2016 led HMRC to the conclusion that sales were being suppressed. Assessments and penalties followed; some were vacated and replaced, and the judge had to decide which were still "live". She summarised the "appeal position" in relation to each of the assessments, including clarifying whether the appellant could appeal with or without submitting a return or depositing the tax (or pleading hardship).

The judge made various directions to allow the parties to regularise the process of the appeal, failing which it would have to be struck out.

First-Tier Tribunal (TC07799): *Yun He T/A New China Restaurant*

A company applied to be allowed to proceed with an appeal against an assessment to £9,113 without paying the tax on the grounds of hardship.

Judge Nigel Popplewell referred to two recent decisions that set out the principles in this area: *NT ADA Ltd* (FTT 2019) and *Elbrook (Cash & Carry) Ltd* (UT 2017).

The judge reviewed the history of the present appeal. The only reason given for the hardship application to HMRC before the application was rejected was a statement that the company was awaiting a substantial corporation tax refund from HMRC. That did not constitute sufficient evidence for the officer.

However, the judge had to take a decision based on the situation at the date of the hearing, when further assertions had been put forward by the company's representative. The pandemic was now in progress, and the judge summarised the representations as follows:

(1) The appellant is receiving no income.

(2) It is paying £17,450 per month by way of salaries which are not reimbursed under the furlough scheme.

(3) Its stock is likely to be discarded or sold at a loss totalling approximately £17,000.

(4) It is paying £2,100 per week for security services.

(5) It is paying fixed costs of approximately £15,000 per month.

(6) The appellant is not eligible for a government hospitality grant.

(7) The appellant banks with Coutts & Co.

(8) Coutts is not an accredited lender under the Bounce Back loan scheme for government backed loans.

(9) The appellant cannot approach another bank as other lenders are only currently servicing the requirements of their existing customers.

The judge understood that paying the VAT would add to the financial problems, but the company had not provided any evidence that it would cause hardship in the meaning of the statute. The company was able (somehow) to meet monthly payments of £40,000 without the benefit of the £80,000 CT repayment, and without further explanation and evidence, it could not convince the Tribunal that it could not pay £9,113 in disputed VAT. The hardship application was refused.

First-Tier Tribunal (TC07746): *QN Hotels Ltd*

6.8.6 Procedure

A trader was assessed to a total of over £360,000 in respect of a lack of invoices to support input tax claims and a failure to keep proper records to justify zero-rating of despatches to the Republic of Ireland, as well as to charge acquisition tax on coal purchased in the RoI. The periods concerned ranged from 11/12 to 11/13, and the assessments were raised from March 2017 to January 2018. A penalty assessment was also raised in the sum of £351,000. One small amendment was made on review, allowing input tax on a vehicle and reducing the penalty to £339,150.

The hearing began with preliminary matters. The appellant applied to vacate or postpone the hearing on medical grounds. This application was refused: the judge noted the guidance given by the High Court in relation to such matters and applied it as follows: "The Tribunal must scrutinise the medical evidence in support of an application to adjourn. Such evidence should clearly identify the medical attendant (which the Note does), and give details of his familiarity with the party's medical condition (including all recent consultations) (which the Note does not), should identify with particularity what the patient's medical condition is (which the Note arguably does not), and the features of that condition which (in the medical attendant's opinion) prevent participation in the trial process (which the Note does not), should provide a reasoned prognosis (which the Note arguably does not) and should give the Tribunal some confidence that what is being expressed is an independent opinion after a proper examination." On balance, there was nothing to show why the appellant could not take part in the hearing; in the event, he did not attend, but he was represented. His solicitors applied again for a postponement, saying

that they were finding it difficult to contact their client; the judge ruled that it was his responsibility to make himself available to his advisers, and there simply was not evidence to support a postponement.

HMRC also applied for the appeal to be struck out, and this also was refused. Regardless of its merit, the application was made at far too late a stage to succeed. The appellant's original grounds of appeal were so vague that an application to strike out might have been entertained, but no such application was made until 2 December 2019, less than two weeks before the hearing and nearly 18 months after the grounds of appeal were filed.

Two days before the hearing, the appellant's representatives applied to amend the outline of his case, claiming that his VAT number and trading identity had been hijacked by other persons. Although the judge was sceptical that this was really a last minute instruction by the appellant (as his solicitors said they could not contact him), he was prepared to let them advance the argument in the hearing, and also to allow HMRC to introduce extra evidence to rebut the argument.

The judge went through the enquiry into the input tax assessment. The officer had contacted the alleged supplier, who had no account for this customer. Many of the invoices were inadequate, and it appeared that they were bogus. There was no good reason to accept alternative evidence.

There was a similar pattern with the invoices for haulage work supposedly done for a RoI customer. Using the mutual assistance procedures, HMRC established that the customer had no record of doing business with this supplier after 2012. Again, the officer's assessment was upheld as being to best judgement and with no evidence brought forward to displace it.

The mutual assistance procedures also underpinned the assessment on purchases of fuel from a RoI supplier. The evidence was coherent and convincing.

The belated argument based on the hijacking of his VAT number and trading identity was considered. The credibility of this explanation was not helped by its very late introduction into the argument – it had not been mentioned anywhere before, and the fact that the appellant was not prepared to be cross-examined on it counted against him. The evidence was compelling that he had made the purchases.

Having upheld the assessments in full, the judge turned to the penalties. These had been calculated on the "deliberate" scale for the first two issues, with a small reduction for "giving", resulting in a charge of about 65% of PLR; the acquisition assessment was assessed on "deliberate and concealed" at 100% with no reduction at all. The judge considered all the factors that affect the calculation, and upheld the penalties in full.

First-Tier Tribunal (TC07765): *Mr Padraig Daly*

A company appealed against refusal of input tax claims for £124,000 on *Kittel* grounds. There were 15 disputed transactions in memory cards during 2015 and 2016. The company appealed against the disallowance, a decision to deregister, and also a penalty of £71,670 (deliberate but not concealed) that was the subject of a personal liability notice served on the director.

The Official Receiver later withdrew the company's appeal, but the individual's appeal came before the Tribunal as HMRC had applied for strike-out (no reasonable prospect of success) and the individual had applied for an order requiring further and better particulars of HMRC's case.

Dr Christopher McNall considered that it would be unfair in the circumstances to strike out the appeal, but he also refused to grant the appellant's application. In his view, HMRC's statement of case was adequate for him to know the case he had to answer; he had failed to provide an adequate response to it, in spite of being subject to repeated Tribunal orders.

The judge made orders to the appellant to provide further information or to suffer the "peremptory sanction" of having his appeal struck out. He made various comments in response to points raised by the taxpayer's representatives, pointing out that precedent case law ruled out several of the arguments that they appeared to be advancing. However, he did not agree with HMRC's view that the appellant could not dispute the underlying liability of the company on which his personal liability was based; that would be a matter for the Tribunal called upon to hear the substantive appeal.

First-Tier Tribunal (TC07808): *Igen Distribution Limited (In Liquidation) And Another*

6.8.7 Disclosure

HMRC raised an assessment on RBS on *Kittel* grounds in relation to trading in emissions allowances in the periods 06/09 and 09/09. In 2017 the FTT found as a preliminary issue that the assessments had been raised in time; the substantive hearing has been listed for 6 weeks in November and December 2020. HMRC sought a direction requiring disclosure of certain documents and information, and the bank disputed that direction before the FTT.

The same transactions were the basis of the dispute in the High Court hearing of *Bilta (UK) Ltd* (April 2020 update) in which the liquidators of various insolvent companies claimed that their directors knowingly participated in MTIC fraud and that two traders at RBS assisted in this and the banks were therefore liable to pay compensation. The High Court found that the claim was well founded, and it is not clear whether the bank will appeal against the decision.

It was common ground that the bank had already made substantial disclosures in the *Bilta* litigation, including some 30,000 documents in September 2018, together with over 3,500 of audio recordings, and considered that this was also the relevant information for HMRC. The bank had carried out searches of its records to identify relevant information; HMRC were concerned that only 2.5% of 1.2 million potentially relevant documents had been disclosed, and did not consider that they had had an adequate explanation of how the search exercise was carried out. They were not party to the *Bilta* litigation and therefore had had no say in the disclosure process.

The bank argued that the order sought was not reasonable nor proportionate, and that a search in the terms stated would be unlikely to

produce any further relevant documents, but would involve excessive time and cost.

The FTT considered that the Tribunal's normal disclosure rules should be followed, rather than the CPR, in a MTIC case where all that was alleged was means of knowledge rather than direct dishonest participation in a fraud. Judge Christopher Staker considered the principles of disclosure in some detail, and set out the fundamental starting condition for an order for specific disclosure as follows:

"That the material in respect of which specific disclosure is sought is necessary to deal with the case justly: this will be the case if the party applying for specific disclosure will suffer an unfair disadvantage (or the other party an unfair advantage) in the litigation as a result of lack of access to the material; that is, it is not enough that the material is merely relevant to the case or that the material would fall to be disclosed under a regime of standard disclosure."

HMRC's hearing bundle for this hearing totalled some 1,162 pages, but did not explain clearly why the material that they listed was necessary for "dealing with the case justly". The judge considered that the burden was on HMRC to make that out, and they had failed to do so. The application was refused.

First-Tier Tribunal (TC07803): *Royal Bank of Scotland Group plc*

6.8.8 Costs

HMRC applied for costs of £45,248 when a trader withdrew an appeal in a case about denial of input tax of over £23m on purchases of wine, beer and soft drinks, and deregistration on the grounds that the business was principally registered for abusive purposes. The director of the company had in 2019 pleaded guilty to cheating the public revenue prior to the withdrawal.

HMRC's application for costs was made out of time because of an apparent internal communication problem within HMRC. Nevertheless, the judge (Amanda Brown) decided that a costs order was appropriate, because the guilty plea showed that the appeal had always been spurious. She ordered that costs incurred after 27 March 2019 (the date of the guilty plea) should be excluded from the claim because, from that date, HMRC should have put the trader on notice that they would seek costs.

First-Tier Tribunal (TC07847): *Golden Harvest Wholesale Ltd*

In TC07182, the FTT decided in favour of the appellant charity that supplies of payroll services to disabled persons was ancillary to the exempt care provided by personal assistants, and therefore qualified for exemption as "a supply of services closely linked to welfare work". HMRC appealed to the Upper Tribunal on two grounds, one of which had not been raised before the FTT: that the payroll service could not be "ancillary" because there was no principal exempt supply. The carer was an employee of the disabled person and was therefore not capable of making a "supply" for the purposes of VAT.

The charity conceded the appeal on the basis of this new ground. However, it applied for costs, summarily assessed, on an indemnity basis, on the grounds that HMRC had acted unreasonably in the conduct of the

proceedings. In essence, had HMRC run their better argument earlier, the charity would not have contested it and would not have incurred the considerable expenses associated with the FTT hearing. The costs claimed were £44,706.

Judge Swami Raghavan considered the principles of awarding costs. In remaking the FTT decision, the UT had the power to make any award of costs that the FTT would have made. He then reviewed the history of the case: HMRC had issued the original decision on 11 January 2013; the charity appealed on 6 June 2013; HMRC's original statement of case was filed on 4 June 2014; there were significant delays, including time for HMRC to carry out a consultation, until the hearing finally took place in January 2019; the new ground was only raised after the FTT had found in the charity's favour.

The essence of the charity's position was that it had assumed that HMRC had conceded that the main supply of care was exempt. HMRC denied that they had done so; the judge stated: "Having considered the correspondence between the parties I was referred to, I am satisfied there was no explicit concession made by HMRC that the principal supply was exempt and further that a careful and literal reading of the extracts in HMRC's correspondence could sustain their argument before me that their case was simply about the qualitative nature of the supply. However, it is also the case that the subtlety of that point, was lost on CCIL, who along with the FTT (as it recorded at [53]) clearly proceeded on the assumption that a concession had been made. As I come on to mention below the question of whether any concession had been made remained ambiguous, neither party establishing clarity on the point."

The judge went on to note that there is "ample" case law about a party continuing to run a bad argument and failing to concede sooner. That is not the case with the opposite argument, of failing to produce a good argument sooner. Nevertheless, the judge considered that similar principles applied in determining whether that was unreasonable conduct. The tests applied in the reverse cases could be adapted as follows:

(1) What was the reason for HMRC raising Ground 2 as a new ground before the UT?

(2) Having regard to that reason, could HMRC have raised Ground 2 at an earlier stage in the proceedings?

(3) Was it unreasonable for HMRC not to have raised Ground 2 at an earlier stage?

HMRC's representative claimed that the new ground was raised as a result of the charity making its oral submissions to the FTT about the principal/ancillary argument. The judge accepted that this might be true, but still considered that it was something that was clearly within the scope of the case from the outset – it could have been included in HMRC's original statement of case. The centrality of the point to the argument was "in plain sight", and it should have been raised earlier.

HMRC argued further that it could not and should not be expected to answer all the points that an appellant might raise in argument. The judge considered that a reasonable respondent would have stood back and dealt with the grounds of appeal taking account of the wider context and the principles relevant to the legislative provision in issue, and would have

identified the fundamental problem with the charity's argument. The failure to do this constituted unreasonable conduct.

The judge did not consider that HMRC's conduct was unreasonable to a high degree, and the charity's advisers should bear some of the responsibility for failing to appreciate the weakness in its case. He ordered that HMRC should not be liable for the costs of considering the new ground (leading to withdrawal of the appeal), and a discount of 30% should be applied to the remainder to reflect the advisers' share of the responsibility. VAT should be adjusted to the extent that it might be partly recoverable. The parties were directed to negotiate an agreed figure on that basis.

Upper Tribunal: *HMRC v Cheshire Centre for Independent Living*

6.9 Other administration issues

6.9.1 Autumn package

The Chancellor cancelled the Autumn Budget that might have been expected to take place at the end of November, and replaced it with an announcement of further measures to mitigate the effects of the pandemic on businesses and other taxpayers. The main VAT measures are:

- extension of the right to defer VAT payments (see 6.3.1);
- extension of the reduced rate for hospitality and tourism (see 2.5.1).

www.gov.uk/government/publications/winter-economy-plan

In an article in *Taxation*, Richard Curtis reviews the autumn announcement of extended support for business.

Taxation, 1 October 2020

6.9.2 Draft legislation for Finance Bill 2021

On 21 July 2020, HMRC published draft legislation for the next Finance Bill (which will eventually become Finance Act 2021). The main points of relevance to VAT are:

- expansion of the s.33 VATA 1994 refund scheme to include S4C, the Welsh public broadcaster, in respect of its non-business activities;
- the proposal of a new range of measures to strengthen existing sanctions for promoters and enablers of tax avoidance schemes.

www.gov.uk/government/collections/finance-bill-2020-21

6.9.3 Insolvency

HMRC have updated their Notice *Insolvency*. It includes new postal addresses for Debt Management; information on how to make an online payment is added, along with details of the payment reference number and suffixes to show the type of insolvency the dividend refers to.

Notice 700/56

The *Insolvency Act 1986 (HMRC Debts: Priority on Insolvency) Regulations 2020* form part of the legislation to amend the Insolvency Act 1986 to make HMRC a secondary preferential creditor in insolvencies after 1 December 2020. FA 2020 ss.98 –99 provide for the priority of certain HMRC debts on insolvency. Priority is due to VAT and "relevant deductions". These Regulations specify the following as relevant deductions: tax deducted under the Construction Industry Scheme (CIS), employee National Insurance contributions (NICs), income tax deducted under Pay As You Earn (PAYE) and deductions in respect of student loans. The regulations come into force on 1 December 2020.

SI 2020/983

6.9.4 Consultation responses

In its submission to HMRC's consultation on *Tackling Promoters of Tax Avoidance*, the CIOT has stated that the government is right to be taking a robust approach to those who continue to devise, promote or sell tax avoidance schemes. CIOT favours HMRC targeting resources on the activities of a small number of promoters and boutique firms who are involved in such avoidance schemes, rather than introducing new rules which might place additional compliance obligations on tax advisers and tax agents in general. It has also raised concerns about the danger of new measures focusing on tax advisers or tax agents, who may not be involved in promoting avoidance, rather than the intended target promoters, who may not pose as advisers at all.

www.tax.org.uk/policy-technical/submissions/tackling-promoters-tax-avoidance

6.9.5 Articles

In an article in *Taxation*, Charlotte Barbour and Susan Cattell consider the potential benefits of reforming the tax system. Although Brexit and the coronavirus pandemic have created considerable uncertainty, they may have produced an opportunity for tax reform. The writers call for a public debate to inform the development of tax policy. The Institute of Chartered Accountants of Scotland has made recommendations for tackling key tax issues in *Future of Taxation in the UK*.

Taxation, 23 July 2020

In another article, Neil Warren brings together recent VAT changes relating to the coronavirus crisis, including the advanced date for zero rating electronic publications and the delay to the domestic reverse charge on construction services. He also recalls that the Conservative election manifesto promised not to raise VAT rates for the duration of the Parliament.

Taxation, 2 July 2020

In another article, Mala Kapacee discusses the possible regulation of the tax advisory profession, which is subject to a current consultation.

Taxation, 9 July 2020

6.9.6 Tax gap

The National Audit Office has published a report setting out HMRC's approach to "Tackling the tax gap". HMRC define the tax gap as the difference between tax collected and the theoretical amount that would be collected if all taxpayers complied with the letter and spirit of the law. Their definition and their estimate of the tax gap informs their policy in allocating resources to compliance measures.

The report notes that tax gaps tend to be higher where taxes are collected by intermediaries and reporting is confined to the minimum, as with the self-assessment of VAT by traders. Nevertheless, the tax gap as a percentage of VAT revenue has fallen measurably in recent years, and HMRC believe that Making Tax Digital will lead to a further improvement.

www.nao.org.uk/report/tackling-the-tax-gap/

The calculation of the tax gap, and HMRC's actions based on it, are considered in an article by Jay Sanghraika in *Taxation*. The sophisticated "Connect" software is the key data analysing tool used by HMRC, developed with the help of BAE Systems and introduced in 2010. It is said to have cost £100m, but has recovered more than £3bn in taxes since its launch.

Taxation, 16 July 2020