VAT UPDATE
JANUARY 2017

Covering material from October – December 2016

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1. INTRODUCTION

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

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

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

1.1 Appeals pending

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

The HMRC website section says that it will be updated "on a monthly basis", but it appears to be less frequent or regular than that. The latest update appeared on 6 September 2016, after a gap since April 2016 (i.e. there has been no update in the list since the October 2016 update).

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

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

1.1.1 UK appeals awaiting hearing or decision

- *Associated Newspapers Ltd*: HMRC have appealed to the CA against the UT's decision that SI 1993/1507 did not apply (hearing listed for December 2016).
- *BPP Holdings*: HMRC have been granted permission to appeal to the Supreme Court against the CA's ruling that the FTT was correct to bar HMRC from further participation in the proceedings.
- *HMRC v Bratt Auto Contracts Ltd and another*: taxpayer has been granted permission to appeal to the CA against the UT's ruling that its *Fleming* claims did not meet the statutory requirements for claims to be recognised, and therefore missed the 31 March 2009 deadline (hearing to commence 28 or 29 June 2017).
- *Brockenhurst College*: CA has referred questions to CJEU about application of education exemption to meals supplied to third parties in order to train students in waiting and cooking (A-G's opinion in this update).

- *C Jenkin & Son Ltd*: both sides have appealed a FTT decision in which HMRC assessed to disallow input tax on the basis that the company made exempt supplies, but the FTT held that the assessment was invalid because it should have charged output tax.
- *CCA Distribution Ltd*: the UT remitted matters in dispute back to the FTT; an oral permission hearing for an appeal to the CA is listed for 18 October 2016.
- *The Chancellor, Masters & Scholars of the The University of Cambridge*: HMRC have been granted leave to appeal against the UT's decision that VAT incurred on investment management was residual input tax of the whole operation (hearing listed January 2017).
- *Colaingrove Ltd*: HMRC's list used to contain four separate appeals, but this has been reduced to just TC02534 (fuel – UT decision in favour of HMRC that the lower rate did not apply because there was a compound supply of "caravan with electricity"); the company has been given permission to appeal to the CA, hearing set for February 2017. The cases about removable contents/definition, removable contents/apportionment and verandas are now resolved.
- *Dynamic People Ltd*: HMRC sought leave to appeal Judge Bishopp's FTT ruling that a special method continued until it was cancelled, even though the company had joined a group; the FTT decided to set aside its decision and rehear the case.
- *E Buyer Ltd and Citibank NA*: HMRC are seeking leave to appeal to the CA against UT's confirmation of FTT ruling that HMRC's statements of case were inadequate – they have to explicitly plead fraud or not suggest it at all.
- *ETB (2014) Ltd v HMRC*: company is applying for leave to appeal to the CA against the UT's decision on its default surcharge of £972. The UT held that the FTT had not properly dealt with facts relied on by the taxpayer, but in remaking the decision also dismissed the appeal.
- *IFX Investment Co and others ("Spotting the Ball")*: HMRC are seeing leave to appeal the CA's ruling in favour of the company, holding that it was supplying exempt games of chance.
- *Investment Trust Companies (in Liquidation) v HMRC*: after the CA effectively reversed the High Court's decision in relation to the companies' direct claims for overpaid VAT, both parties appealed to the Supreme Court (hearing concluded 19 May 2016, judgment reserved).
- *Littlewoods Retail Ltd*: HMRC have been granted leave to appeal to the Supreme Court against the CA's decision in favour of the company on the question of compound interest on long-term repayments. HMRC are appealing on both liability and amount, hearing listed for 3 – 6 July 2017.
- *Mercedes-Benz Financial Services*: HMRC appealed the UT decision that the company's product was leasing rather than HP to the CA,

which decided to refer questions to the CJEU (questions in this update).

- *Metropolitan International Schools*: HMRC have been granted leave to appeal to the UT against the FTT's decision that the taxpayer supplied predominantly printed matter with incidental services (hearing listed for February 2017).
- *Newey t/a Ocean Finance*: HMRC have been granted leave to appeal to the Court of Appeal against the UT's decision that the FTT was correct to find that the appellant's offshore business arrangements were not an abusive practice, hearing listed for March 2017.
- *Privin Corporation Ltd*: the FTT found in favour of a MTIC appellant. HMRC have been granted leave to appeal to the UT (hearing listed for November 2016).
- *SAE Education Ltd*: the company will appeal to the CA in June 2017 against the UT's ruling (in this update) that the FTT was wrong to allow exemption to the taxpayer as a "college of a university".
- *Taylor Clark Leisure plc*: HMRC are seeking leave to appeal against the Court of Session's ruling that the company was entitled to a repayment based on a claim made by a former member of its VAT group registraiton.
- *Temple Finance Ltd and Temple Retail Ltd*: HMRC have been granted leave to appeal against the FTT's ruling that, in the main, Sch.6 para.1 directions were not possible and the standard method override did not apply.
- *United Grand Lodge of England v HMRC*: taxpayer will apply for leave to appeal to the CA (commencing 9 November 2016) against the UT's confirmation of the FTT's decision that it did not qualify as a body with philosophical, philanthropic or civic aims.
- *Victor Dunlop*: HMRC have been granted leave to appeal to the Upper Tribunal against the FTT's decision that part of a garage conversion qualified for a DIY claim. The list says "Upper Tribunal hearing vacated", so it is not clear what is happening.
- *Volkswagen Financial Services Ltd*: HMRC have been granted leave to appeal to the Supreme Court against the CA's ruling that VWFS's proposed special method was more fair and reasonable than HMRC's proposal (hearing concluded 3 November 2016, judgment reserved).
- *Wakefield College v HMRC*: the college has applied for leave to appeal to the CA against the UT's ruling that it would use its building for a business purpose and therefore did not qualify for zero-rated construction (leave hearing listed for 27 April 2017).
- *Wheels Private Hire Ltd*: HMRC are appealing the FTT decision that a taxi firm made separate supplies of exempt insurance to drivers who paid taxable rent for radios.

1.1.2 Unresolved cases not on the list

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

- *Copthorn Holdings Ltd*: HMRC were refused (by the FTT) leave to appeal against the FTT's decision that they should reconsider their refusal to allow retrospective grouping. They have decided not to apply to the UT for permission; it remains to be seen what will happen next, because the decision of the FTT required HMRC to consider again their original decision.
- *John Wilkins Ltd and others*: Supreme Court refused HMRC permission to appeal one aspect of the case, in which the Court of Appeal decided that motor dealers were entitled in principle to claim compound interest on VAT repayments. Substantive issue stayed pending the *Littlewoods* decision (now awaiting a Supreme Court ruling after the HC and CA both applied the CJEU's judgment in Case C-591/10 in favour of the taxpayer).
- *Whistl UK Ltd*: the Court of Appeal will hear a further application for judicial review after the High Court held that the UK's amendments to the VAT exemption for postal services were compatible with EU law (hearing April 2016).

1.1.3 Cases in the current update

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

- *Finmeccanica Group Services SpA*: taxpayer has lost its appeal to the Court of Appeal against the UT's ruling that it was making supplies in the UK and was therefore not entitled to a refund under the 8th Directive or the electronic refund procedure.
- *GMAC UK plc v HMRC*: the UT reaffirmed its own decision in favour of the taxpayer on the basis of the CJEU decision (Case C-589/12). HMRC appealed to the CA, which found for HMRC on one ground but rejected the other three.
- *Kati Zombory-Moldovan t/a Craft Carnival*: HMRC have won their appeal to the Upper Tribunal against the FTT's ruling that the trader was making exempt supplies of land.
- *MG Rover Group Ltd*: HMRC have won their appeal against the FTT's decision about who is entitled to claim a refund where an overpayment was made on a group VAT return.
- *Wilton Park Ltd*: company lost its appeal to CA against FTT and UT decisions that its charges to dancers for redeeming "Secrets Money" were standard rated.

2. OUTPUTS

2.1 Scope of VAT: linking supplies to consideration

Nothing to report.

2.2 Disbursements

Nothing to report.

2.3 Exemptions

2.3.1 Insurance intermediary

An insurance agent regarded its supplies as "exempt with credit" under the Specified Supplies Order on the grounds that they were supplied to a Gibraltar company. HMRC ruled that the supplies were made in the UK and assessed to disallow related input tax. It was agreed before the hearing that the company's supplies fell within Item 4 Group 2 Sch.9 VATA 1994, and that the Gibraltar company was a person belonging outside the EU. The only issue for determination was therefore whether the supplies were made to the Gibraltar company or to consumers in the UK.

The company had applied for registration in 2010 and backdated it to 2007 in order to claim input tax on specified supplies. At the time, HMRC had accepted the registration and made a retrospective repayment. In 2013, HMRC carried out a routine visit to the company and became concerned that it was supplying its intermediary services to the insured persons – consumers in the UK – rather than the insurer in Gibraltar. Following a review, a decision was issued together with assessments totalling £163,000.

The Tribunal examined the way in which the company acquired business, and the way in which insurance policies were presented to consumers who contacted the company. Most of the business came from lead generators and personal recommendations, not from the Gibraltar company. The Tribunal concluded that the question of whether the supplies were made to the consumers or the insurer fell within the principles of *Airtours*, *A1 Lofts* and *Loyalty Management*:

(1) We will consider the whole of the relevant combinations of transactions and the whole of the relationships between the relevant persons (TWIC, Unicom and the consumers).

(2) We will take the contractual position as between the various participants in the arrangements as our starting point since we should, in normal circumstances, characterise the relationships by reference to those contracts.

(3) We will then consider whether the contractual position represents the "economic reality" of the arrangements. In performing this exercise, we will take into account that the contractual relationships will normally represent economic reality but that there will be circumstances where this

is not the case, including but not limited to situations where the contractual terms constitute a purely artificial arrangement which does not correspond with economic and commercial reality.

There was a technical question about the operation of the Specified Supplies Order. The Tribunal concluded that art.3(c) of the Order, on which the company relied, could not apply: that referred to intermediary services, but it required the underlying insurance transaction to be supplied to a person belonging outside the Member States, which was not the case. However, the company was allowed to amend its grounds of appeal to rely on art.3(a), which only required any service within Group 2 to be supplied to a person belonging outside the Member States.

The Tribunal's view of the service agreement between the agent and the insurer was that the insurer appointed the agent to provide intermediary services, and to pay commission which would be deducted from premiums received from consumers. HMRC's counsel argued that the company's website indicated to consumers that the company would represent them; but the Tribunal did not consider that this was a contractual statement, nor were there detailed contractual terms and conditions on the website. There was a very limited contract between the consumers and the company, but the "direction of supply" was clearly between the company and the insurer. This was the economic reality, given that 95% of the business was placed with the particular insurance provider.

The appeal was allowed.

First-Tier Tribunal (TC05509): *Unicom Insurance Services Ltd*

2.3.2 Secrets money

A group of companies operated licensed lap dancing or table dancing clubs in London under the trading name 'Secrets'. A dispute arose as to the correct VAT treatment of vouchers called 'Secrets money'. A patron who had run out of cash could buy a voucher using a debit or credit card. The company charged a 20% commission on top of the face value (so £100 in 'Secrets money' cost £120); if the voucher was given to a dancer in consideration of her services, she could cash it in at the end of the evening, and would be charged another 20% by the club – so she would receive only £80.

It was agreed that the 20% commission on the sale of the voucher was consideration for a taxable supply to the patron – it was a face value voucher issued at more than face value.

It was also agreed that the 20% charged to the dancer was consideration for a supply of services made by the company to the dancer. The club claimed that it was consideration for a 'dealing in credit guarantees or any other security for money' within Item 1 Group 5 Sch.9 VATA 1994. In 2009, it made a claim for repayment of just over £500,000 in VAT accounted for in the preceding 3 years. HMRC raised an assessment for just over £40,000 in respect of two return periods in 2009 in which they believed the companies had treated the income as exempt. It is not clear how the vouchers were treated after that.

HMRC considered it to be a standard taxable supply. The company was not a dealer in financial instruments, and the vouchers were not in the nature of the securities that were referred to in Group 5; the commercial

reality was that the company provided the dancers with the opportunity to carry on their activities, and the vouchers were a means of enabling that service to be provided.

First-Tier Tribunal

The FTT (TC03255) examined the way in which the business operated, including the contracts between the companies and the dancers, the terms and conditions attaching to Secrets money, and the extent to which customers disputed that they had bought it (the company suffered chargebacks of only £16,000 on £22.5m over a 3 year period – less than 0.1%).

The company argued that precedent cases, including *Dyrham Park Country Club* (VTD 700) and *Kingfisher plc v C&E* (HC 2000) suggested that ‘security for money’ should be given a wide meaning; and others such as *Sparkassernes Datacenter v Skatteministeriet* (Case C-2/95) and *HMRC v AXA UK plc* (Case C-175/09) suggested that the exemption should not be restricted to financial institutions.

The FTT accepted that ‘security’ has a wide meaning, and that the vouchers were ‘securities for money’. It also accepted that a security for money can be issued by someone other than the persons listed in Note 4 Group 5 (‘a person carrying on a credit card, charge card or similar payment card operation’). The company extended credit by paying cash to the dancers before the credit or debit card company would pay them; the minimal nature of the exposure to the risk of chargebacks was irrelevant.

The FTT went on to examine whether the discount on redemption of the vouchers was in reality consideration for a financial transaction, or was consideration for some other service provided by the company to the dancers. The company’s representative argued that there was no link between that discount and the opportunity to dance: dancers could refuse to accept Secrets money by declining an invitation to dance at a customer’s table, and might only be paid in cash for the evening. They also paid the company an ‘entry fee’ for the opportunity to dance.

HMRC argued that there was a composite supply of services by the company to the dancers for a composite consideration, and the discount on the vouchers was part of that consideration. It could not be looked on in isolation, but must be examined in the wider context. The entry fee was consideration for the opportunity to dance, and the discount was consideration for access to a wider ‘market’ – customers who did not have enough cash, but had Secrets money to spend.

The FTT accepted this contention. The discounts were not consideration for a separate financial supply. The appeals were dismissed, and the companies appealed further to the Upper Tribunal.

Upper Tribunal

The Upper Tribunal rehearsed the facts of the case, then examined the decisions of both Sir Stephen Oliver and Neuberger J in the *Kingfisher* case. HMRC argued again that the vouchers were not ‘a security for money’, but the UT judge agreed entirely with the reasoning and conclusion of the FTT. Even though the vouchers did not expressly include a promise to pay money on their face, there was an implication

that the dancers would be able to encash them – if that did not happen, the scheme would rapidly collapse.

In relation to the nature of the supply, the appellants' counsel argued that the FTT had been wrong to "throw all the factual background into the mix" in determining that the commission was part of the consideration for the composite supply of "access to customers" by the club to the dancers. He argued that the FTT should have started with the contractual position and should have considered the background facts only as a "sense check" of the result. Alternatively, the nature of the supply by the club to the dancers was much more limited: any other benefits to the dancer, beyond the ability to encash the vouchers, were more akin to the benefit to Woolworths in relation to the voucher scheme considered to be exempt in *Kingfisher*.

The judge examined the "contractual position" argument, for which counsel relied on the Supreme Court's decision in *SecretHotels2*. She did not agree that the facts were sufficiently similar for that precedent to be of assistance. There were no written contracts purporting to set out comprehensively the rights and duties of the club and the dancer. In the absence of such documents, the rights and duties have to be drawn from such documents as do exist together with the way the clubs conduct their business.

The judge went on to distinguish the Secrets voucher scheme from that operated in *Kingfisher* or by credit card companies. A retailer is solely responsible for providing the infrastructure and ambience to attract customers to come and spend their money in its stores – the credit card company or voucher provider has no role in that. In this case, the dancers are in the position of "retailer", and the club is "the credit card company". The dancer can only make money out of the vouchers if the rest of the club's facilities are also provided to her.

The judge considered that the encashment of the vouchers could not be separated out as part of a multiple supply from club to dancer. There was a composite supply of which the vouchers formed part. That composite supply went well beyond the scope of item 1 Group 5 Sch.9 VATA 1994. The commission was consideration for a taxable supply, and the appeal was dismissed again.

Court of Appeal

The company accepted that there was a service of "providing access to customers" included in the supply for which the discount on the vouchers was consideration, but it argued that this was still a composite exempt supply within item 1 of Group 5.

Richards LJ noted that the FTT's decision did not exactly reflect the argument that HMRC had put forward: HMRC had argued that the encashment of the vouchers was a separate supply that was not exempt, but the FTT had concluded that there was a composite supply for two-part consideration. HMRC had adopted this alternative line in the UT. The appellants argued that HMRC's original argument was correct in identifying two separate supplies – one for the entry fee and one for the vouchers – and the second was primarily for a financial service.

The judge also noted that the UT had reached a decision based on HMRC's original argument: the UT judge had disregarded the entrance

fee and concluded that the discount on redemption was, viewed on its own, consideration for a taxable supply. It therefore appeared that the two Tribunals had come to the same conclusion but for different reasons.

The judge considered that the UT judge had come to a justifiable evaluative conclusion on the basis of the primary facts found by the FTT. In particular, the 20% rate of discount suggested that there must be more than a financial service: the company had not attempted to justify this as a market rate for an encashment service where there was minimal credit risk. From the standpoint of the typical dancer, the economic reality was that the discount was for the use of the facilities of the club. It was not necessary to consider the alternative conclusion of the FTT or whether it was justified; the UT judge's reasoning was sound. The three appeal judges unanimously dismissed the companies' appeal.

Court of Appeal: *Wiltonpark Ltd and others v HMRC*

2.3.3 Game of chance

On 8 December 2016, the Supreme Court refused HMRC permission to appeal against the CA ruling in favour of *IFX Investment Company Ltd and Others* (originally "*The Spotting the Ball Partnership*"). The CA's judgment, that "Spot the Ball" was a game of chance and the entry fees were therefore exempt from VAT, is now final and the company will receive its substantial repayment claim.

UKSC 2016/0120

2.3.4 *Brockenhurst* opinion

The *Brockenhurst College* case is about restaurant meals and public performances that are received by members of the public in return for payment, but are provided as an essential part of training courses in catering and performing arts by a college. In HMRC's view, they cannot be exempt as "education" or "services closely connected with education" because they are supplied to someone other than the recipient of the education. The UK FTT and UT decided that the benefit to the direct recipient was incidental to the educational aim of the supply, and the services fell within the exemption. The UT considered that it was not necessary to rule on whether the UK legislation was consistent with the Directive in requiring "direct use" by the recipient of "closely related services": a conforming construction could interpret the direct benefit of the student's education as "direct use".

The Court of Appeal decided to refer questions to the CJEU, where Advocate-General Kokott has now given an opinion. She noted the difficulty in defining the borderline between supplies that were "closely related" and those that were "no longer closely related". In trying to define that borderline, she made the following points.

The Court has held that "closely related" means "ancillary to the principal supply". That would suggest that the recipients would have to be identical, because different recipients would necessarily imply distinct supplies. However, she did not consider that art.132(1)(i) and art.134 implied that "closely related" had to mean "ancillary" in this context. If it did, there would be no need for the explicit mention in the PVD, because they would enjoy exemption under *CPP* principles in any case.

The "closely related" supply referred to must therefore be an independent or principal supply in its own right, but is exceptionally accorded exemption because of its close relationship to the educational supply. Art.134 then imposes the extra requirement that it must be essential to the educational supply.

Under this analysis, it would be possible for a supply to a third party to be "closely related"; but the purpose and objectives of the tax exemption should be considered. These are to prevent an increase in the cost of education arising from VAT. This is a benefit for the consumer, not for the business. In this context, an exemption of supplies that are consumed directly by third parties and are 'produced' only on the occasion of training is difficult to justify.

In addition, the principle of fiscal neutrality militated against allowing exemption to supplies made to those who were not themselves receiving training, because there would be a disadvantage for directly competing suppliers. The UK government argued that the potentially higher error rate in a training restaurant was allowed for in the lower consideration (payment of 80% of the meal cost), and it did not change the nature of the service itself.

The limitation of recipients to people registered in advance (e.g. friends and relations of students) did not change the nature of the supply. On fiscal neutrality grounds, the training restaurant would still be competing with VATable establishments, and it should charge VAT just as a Members' Club has to on catering supplies.

The strict interpretation of exemptions required the word "essential" to be given its proper meaning. The CJEU held in the case involving Germany that carrying out research projects for third parties was helpful for university education, but it was not essential to it, so it could not be exempt.

In the A-G's view, charging VAT on the supplies to third parties would not increase the cost to the recipients of the education, so the purpose of the exemption did not require those supplies to benefit from it. The taxation of the supplies in the present case 'merely' makes access to the restaurant and theatre services more expensive for the restaurant and theatregoers. It followed that there was no service closely related to the exempt provision of education.

The proposed answers to the questions are:

(1) Closely related transactions within the meaning of art.132(1) PVD are independent supplies, the taxation of which also increases the cost of access to supplies that as such are exempt from tax. They do not include the supply of restaurant and entertainment services by an educational establishment to paying members of the public who are not recipients of the educational services that are exempt from tax.

(2) For the differentiation it is relevant (and militates against the existence of the exemption) that the persons benefiting from the exemption contribute to what is provided to other consumers. It is also relevant that the third parties pay for their own consumption, that is to say, not for the provision of education to the students. Finally, it is also relevant that the supplies to the third parties – both from the perspective of the third parties and the students – pursue an independent objective (providing for

third parties) that is pursued alongside the educational objective that continues to be exempt from tax.

CJEU (A-G) (Case C-699/15): *HMRC v Brockenhurst College*

2.3.5 TEFL

The exemption for education in VATA 1994 Sch.9 Group 6 extends to "education" provided by non-profit making bodies, and also to "teaching English as a foreign language" (TEFL) provided commercially. A group of companies included a company limited by guarantee that was prohibited from distributing profits; it offered various courses that it claimed amounted to TEFL. HMRC did not accept that it qualified as a non-profit company, and also did not accept that the courses were within the exemption for TEFL.

The guarantee company (TETCL) was added to the VAT group of its commercial holding company in January 2003. The group's advisers notified Customs that certain previously taxable courses were being transferred to TETCL and would be treated as exempt because of its non-profit status. Because other connected companies made supplies to it, a disclosure was made under the VAT avoidance schemes legislation in March 2005. In July 2008, HMRC notified the company that it was carrying out further enquiries.

At that time, the company's advisers replied that the company was in the process of gaining accreditation from the Department for Education as a "school", and would therefore qualify as an eligible body in any case; and that several of its courses constituted TEFL. HMRC's further enquiries led them to the view that most of the company's courses were "teacher training" – not TEFL itself, but training TEFL teachers (who were generally not native English speakers themselves). A discussion ensued about what percentage of the disputed courses constituted "teaching methodology" (in HMRC's view, not exempt) and what percentage constituted "pure TEFL"; this also extended to whether the combined supply constituted something that could be regarded as a compound exempt or compound taxable supply on the grounds of *Card Protection Plan* principles.

The judge (Nicholas Paines QC) considered whether Group 6 Note 2, which excludes supplies by a TEFL provider from exemption "insofar as the supply consists of the provision of anything other than TEFL". The judge questioned whether this meant that different rates could be applied to different elements of the same supply. Both counsel argued that "insofar as" in this context meant no more than "if", and did not override *CPP*. The Note simply served to make sure that a TEFL provider was exempt in relation to TEFL courses and not exempt in relation to other courses. The judge decided to follow the approach supported by both counsel.

The non-profit making body issue was decided by reference to *Kennemer Golf and Country Club v Staatssecretaris van Financien* (Case C-174/00) and *Messenger Leisure Developments v HMRC* (CA 2005). The judge concluded from the precedents that the prohibition of profit distribution in the articles was not enough; the fact that the company was an integral part of a commercial group prevented it qualifying as a non-profit body. TETCL also did not plough back all surpluses into the improvement of the

services, as required by the legislation: it made other charitable donations to unconnected good causes.

31 different courses were submitted by the company for consideration. 8 were accepted by HMRC as constituting TEFL. The judge heard witness evidence from several employees of the company and the owner, and considered the content of the company's website in 2009 and 2013. He then examined each of the disputed courses in turn.

The only case law on the subject of TEFL was *Pilgrims Language Courses Ltd v Customs* (CA 1999) which concerned incidental extras such as accommodation and trips to the theatre. The company at the centre of that case was also at the centre of this one, although it had been acquired by the current appellant in 2003. The CA held (overruling the HC) that the various incidental extras were covered by the exemption: the CJEU had just decided *CPP*, and the UK court considered that it applied in this case to the ancillary elements of an essentially TEFL supply.

The company's primary case was that all the courses should be accepted as TEFL because the "teaching methodology" aspects of the courses were "the content being used in a content-based course of EFL". The judge did not accept this argument, and turned instead to make a decision on each individual course as to whether the EFL elements predominated. The judge summarised his task as follows:

"*It seems to me that in the case of each disputed course I must ask myself first whether for the typical participant receiving instruction in methodology is an aim in itself or is ancillary to ('for the better enjoyment of') a supply of TEFL and conversely whether receiving instruction in EFL is an aim in itself or is ancillary to a supply of methodology. If the answer to either question is affirmative, that determines the tax treatment. If not, then I must decide which element predominates along the lines of the Levob judgment. Of the Levob criteria, those applicable to this case are the importance of each element (for I do not see why importance should only be relevant if it attains the level of 'decisive') and its extent.*"

On this basis, the judge concluded that 8 of the disputed 23 courses were exempt, but the rest were not. The appeal was allowed to that extent.

First-Tier Tribunal (TC05476): *Oise Ltd*

2.3.6 Supply of human blood?

Art.132(1)(d) PVD exempts "the supply of human organs, blood and milk". It falls between articles 132(1)(b) (hospital and medical care in institutions), 132(1)(c) (medical care by medical professionals) and 132(1)(e) (dental prostheses).

A German company extracted plasma from human blood and supplied it to a Swiss company for use in the manufacture of medicinal products. Initially it treated the supplies as exempt without credit for input tax, but then made a retrospective claim, arguing that the supply of plasma for this purpose did not fall within the exemption. Questions were referred to the CJEU.

The court ruled that the company was correct. Exemptions had to be strictly applied, and they had to be interpreted in their context. Art.132(1)(d) fell within a series of exemptions "in the public interest"

that were directly concerned with treatment of patients. Use for manufacture of medicines might be indirectly concerned with healthcare, but the link was not close enough to fall within the exemption.

CJEU (Case C-412/15): *TMD Gesellschaft für transfusionsmedizinische Dienste mbH v Finanzamt Kassel II-Hofgeismar*

2.3.7 Ineligible bodies

A charitable boarding school set up two subsidiary companies which were registered as part of a VAT group with it. The subsidiaries managed the school's sports facilities, and made supplies to unconnected third parties of the use of those facilities. Output tax was accounted for by the companies; a claim for a refund of £427,000 was made to recover the excess of output tax over input tax for the periods 11/08 to 08/12. Before the FTT (TC04247), the school argued that the companies were "eligible bodies" because they were subsidiaries of a charity; there was no doubt that the school itself would have been an eligible body for the purposes of the sports exemption.

The companies had made covenants to pay over their profits to the school, enjoying corporation tax relief for such payments to a charity. 1993 and 1998 deeds were not located by the charity until just before the hearing, when they were produced as evidence that the companies were in effect "charitable".

HMRC argued that the companies did not have the articles or memorandum of association of a non-profit company. Their accounts were prepared on commercial lines. The overall business activities of the companies put them outside the category of eligible body.

The UK law permits a sports body to make a profit as long as that profit can only be distributed to another non-profit body. HMRC were effectively arguing that this had to be within the constitution of the companies rather than effected by deed of covenant and carried out in fact. The FTT considered the CJEU precedent of *Kennemer Golf & Country Club v Staatssecretaris van Financiën* (Case C-174/00): it was clear from that case that a sports body could aim to make a surplus, as long as it did not distribute it for the benefit of its members.

The FTT distinguished between "specific facts" that favoured the college, and the legal principles that favoured HMRC. The specific facts were that the companies had only ever paid their profits to the charity, and that the school expressed an intention never to dispose of the subsidiaries to anyone else who might operate them commercially. As a matter of legal principle, there was no bar to the school doing so; the deeds of covenant had expired some years before, so they were no longer binding on the companies. As there was nothing in their constitutions preventing the payment of commercial dividends, they were not in themselves eligible bodies. Profits had been retained rather than paid to the school in all the years from 2009 to 2013, with the stated objective of reassuring suppliers who might examine the accounts, but with the effect that the profits were not being applied in a way that was consistent with the exemption either under UK or EU law.

The appeal was dismissed, and the school appealed to the Upper Tribunal. The appeal was based on Note (2A) Group 10 Sch.9 VATA 1994, which

provides that an eligible body included "a non-profit making body which is precluded from distributing any profit it makes, or is allowed to distribute any such profit by means only of distributions to a non-profit making body". As the school was the only shareholder of the two companies, they could only distribute profits to it, and it was a non-profit making body, so the subsidiaries ought to qualify for exemption. The school argued that the *Kennemer* case showed that the UK law could not be reconciled to the Directive, and it was entitled to rely on the UK law; or that the *Kennemer* case did not support a conclusion that the constitution of a company determined whether it had the aim of achieving profits for its members.

The Upper Tribunal dismissed the appeal. It had to construe Group 10 in a manner that departed as little as possible from the Directive, even if it was not entirely consistent. Read in the light of the Directive, the exemption should depend on the aims of an organisation, not on its results – for example, the fact that it happened not to make profits would not be enough to make it a "non-profit body". It was therefore necessary for there to be something specific in the constitution of the company to prevent distribution to profit-making bodies. The scope for cancellation of the deeds of covenant or sale of the companies to commercial enterprises meant that they did not qualify for exemption.

Upper Tribunal: *St Andrew's College Bradfield v HMRC*

2.3.8 Local authority sport

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

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

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

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

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

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

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

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

2.4 Zero-rating

2.4.1 Hot food

A trader appealed against assessments for the periods from 06/09 to 06/11 totalling £8,930, raised on the basis that he had been treating as zero-rated supplies that should have been standard rated as "catering". He provided a "meals on wheels" service to the elderly and housebound, which involved supplying some hot and some cold meals. HMRC ruled that the hot meals were within the excepted items under Group 1 Sch.8 VATA 1994.

The trader appealed, arguing that:

(i) The supplies fell outside the definition of "in the course of catering" as detailed in VAT Notice 709/1;

(ii) The supplies were not for consumption on the premises;

(iii) The supplies required arranging on serving plates which constitutes preparation by the customer and which falls outside of "in the course of catering".

He further argued that his supplies should be exempted as "welfare services" if they did not qualify for zero-rating.

The Tribunal considered the trader's arguments with care, but could find no merit in any of them. His reliance on Notice 709/1 was misplaced, partly because it did not have the force of law, but mainly because a fair reading of the Notice showed that his supplies should be treated as catering. It was clear from the legislation that hot food was standard rated in all circumstances, regardless of the premises on which they were eaten. Placing food on plates was too insignificant a procedure to constitute "preparation by the customer". Lastly, the service did not fall within the definition of welfare, and he was not a qualifying body for the purposes of the exemption.

The appeal was dismissed.

First-Tier Tribunal (TC05406): *Alan Desmond Manifold t/a Easy Living Meals On Wheels*

2.4.2 Transport of passengers?

A company supplied a yacht and a skipper to an associated company and treated the supply as zero-rated "transport of passengers". HMRC issued a decision, upheld on review, that this should have been standard rated. The hirer was a not-for-profit guarantee company that was not registered for VAT. It provided sailing training to customers, but the appellant was responsible for operating the yacht and complying with any relevant regulations.

HMRC argued that the "passengers" were actually "crew" – the whole point of them being aboard was not to be transported, but to take part in sailing the vessel. The original agreement between the two companies did not refer to passenger transport, which was added later.

HMRC's policy is to allow the parties to determine the borderline between a mere charter of a ship with crew and passenger transport, "as long as transportation takes place". The Tribunal agreed that this was the

correct approach: zero-rating should be available if the supply fell within item 4(a) Group 8 Sch.8 VATA 1994, even if it was possible to interpret the supply differently. The definitions of "passengers" and "transport" had to be sought in the Oxford English Dictionary. Although the participants helped to sail the boat, they were not "members of the crew", and that was enough to make them "passengers". Similarly, they were "conveyed or carried" from one place to another, which meant that the supply fell within the statutory provision.

The appeal was framed as made against the decision to standard rate, rather than against the resulting assessments; the appeal was allowed, and the judge commented that he expected HMRC to vacate the assessments.

First-Tier Tribunal (TC05413): *Sailing Projects Ltd*

2.4.3 For disabled persons

A company constructed and sold swimming pools. It treated the sales of "hydrotherapy pools" as zero-rated on the basis that they fell within Item 2(g) Group 12 Sch.8 VATA 1994 as "appliances designed solely for use by a disabled person". HMRC questioned this at a visit in June 2014; a long correspondence discussing the availability of the relief followed, culminating in an assessment for £21,785 in November 2015, upheld on review in March 2016 after an extension.

The appellant director's argument was mainly based on the unfairness of retrospectively revisiting something that had been accepted by a previous HMRC officer; he also considered that he had followed the instructions in Notice 701/7 as it stood at the time of the sales, whereas HMRC were applying a version reissued in December 2014. The Tribunal judge noted that much of his argument was directed at matters that could not help him; he was relatively dismissive of the evidence that supported his case. The judge therefore "put to HMRC the points that Mr Fallow might have put had he been advised by a specialist".

HMRC argued that the pools were standard models that could be used by anyone, and no adaptations had been made. The issue of unfairness was outside the Tribunal's jurisdiction. There was no dispute about the disabilities of the particular customers to whom the pools had been sold.

The judge concluded that the pools supplied to disabled customers were different from those supplied to able-bodied ones. They would all have extra features such as rails and thermostatic controls; they would be installed indoors instead of outdoors. They constituted a "hydrotherapy suite" rather than merely a container of water. The appeal was allowed.

First-Tier Tribunal (TC05507): *Wearside Civil Engineering Ltd*

2.4.4 Vehicles for disabled

HMRC have taken action against abuse of the zero-rating relief for adapted motor vehicles for disabled wheelchair users. They have lost a number of cases over the years in which the Tribunals have held that the business was entitled to zero-rate a supply on the evidence available to it, but the government is not happy with how the relief operates. Legislation will therefore be included in the FA 2017 to tighten the rules. This follows a consultation exercise as long ago as 2014, following which

HMRC have worked with interested parties to develop new rules that do not negatively affect genuine beneficiaries of the relief.

A Tax Impact and Information Note has been published on how the changes will affect businesses and customers. The law will specify a limit on the number of vehicles within a specified period of time that an individual can purchase under this relief, and will also require the electronic or written submission of the eligibility declaration form published on GOV.UK. Motor dealers selling adapted motor vehicles under this relief will also be required to provide information regarding those sales to HMRC within a specified time frame. There will be a new penalty for incorrect issue of a zero-rating certificate by an individual when ineligible. The new rules will apply from 1 April 2017.

TIIN: VAT relief on adapted motor vehicles for disabled wheelchair users

2.4.5 Books and printed matter

HMRC have announced a change or clarification in policy on the VAT treatment of colouring and dot-to-dot books. There has apparently been a growing market in such products aimed at adults. “Children’s picture or painting books” are zero-rated under Item 3 Group 3 Sch.8, but a painting book aimed at adults would have to qualify under the general definition of printed matter. This has been held to be something that is intended to be “read or looked at”, rather than completed.

HMRC accept that colouring or dot-to-dot books are VAT zero-rated unless one of the following applies. The books are:

- marked as suitable for adults or grown-ups;
- held out for sale in retail shops together with other adult books that are unsuitable for children or are not appropriately marked as suitable for children when for sale on a website;
- contain images reflecting profanity, pornography, violence and illegal acts.

If the book meets any of the three conditions above, it will be a standard rate supply.

HMRC have decided that some publishers could have zero-rated sales in good faith because of a failure to understand the relevance of how the book is held out for sale. Therefore, HMRC does not intend to seek recovery of any tax on colouring or dot-to-dot books sold prior to 1 April 2017 where the content is suitable for children (people under 18 years of age). This is irrespective of how the book was marketed or held out for sale at the time. Books containing unsuitable images should always have been standard rated.

The Brief contains notes about correcting past errors, including reclaiming VAT where books suitable for children have been treated as standard rated.

Revenue & Customs Brief 17/2016

HMRC’s Notice *VAT: zero-rating of books and other forms of printed matter* has been updated to reflect the new policy on colouring books.

Notice 701/10

2.5 Lower rate

2.5.1 Insulation for roofs

A company supplied a "solid roof system" which provided insulation for conservatories. HMRC decided that this constituted a supply of a roof, not insulation for roofs, and was therefore standard rated. The company had initially acted as sub-contractor for another company installing a slightly different system which HMRC had accepted qualified for the lower rate; when the other company became insolvent, the company began to act as main contractor, and HMRC considered that its system (involving the addition of roof tiles to give the impression of a new roof) involved such a significant change to the structure that it constituted the supply of a new roof.

In August 2015 the company had applied for a patent of its roofing system, which application was still pending at the time of the hearing. It is registered with the Local Authority Building Control organisation which monitors compliance with building regulations.

The director stressed that the system was not a replacement for an existing roof. It was attached to a perfectly serviceable existing roof that could be retained by the customer on its own, or more cheaply replaced with a different new roof. The whole point of the company's supply was to insulate the roof.

The company provided a report from an expert, and the judge noted a number of factors that should be taken into account in weighing expert evidence, including the need for care when only one side provided such a report. The report was analysed carefully: the judge noted that only one conclusion constituted "expert opinion"; others related to facts, which were accepted but only repeated the director's evidence; and some conclusions were effectively "argument" and were rejected.

The judge considered in some detail the UT decision in *Pinevale Ltd*, where the company had been held to supply an "insulated roof" rather than "insulation for roofs". He also considered the CJEU decisions in *Levob* and *CPP* and the difference between them. In his view, the company's supply was a single one that should not be apportioned, and it qualified for lower rating. The appeal was allowed.

The decision is long and complex and also covers a number of procedural problems with the appeal, including the failure of the officer to state that a review was available when making the original decision, and the issue of a further decision about a secondary product against which no appeal had been lodged.

First-Tier Tribunal (TC05552): *Wetheralds Construction Ltd*

2.6 Computational matters

2.6.1 Rules for sales through unregistered agents

The *Avon Cosmetics* case was heard by the FTT in the first half of 2014. The Tribunal decided that VATA 1994 Sch.6 para.2 created unjustifiable sticking tax: it required a large business selling through self-employed, unregistered agents to account for output tax on the uplifted retail selling price of the goods, rather than the price received from the agents, without making any allowance for costs incurred by the agents. The Tribunal considered that the unfair extra liability could not be justified by the prevention of avoidance, and that the principle of fiscal neutrality was breached.

The questions for reference have only now been released. The issue is complicated by the fact that Sch.6 para.2 follows a specific derogation granted to the UK by the Council in 1985 and reconfirmed in 1989. The questions therefore ask the CJEU to consider whether the problems perceived by the FTT are enough to make the derogation unlawful, and if so, what the proper remedy should be.

CJEU (Reference) (Case C-305/16): *Avon Cosmetics Ltd v HMRC*

2.7 Discounts, rebates and gifts

Nothing to report.

2.8 Compound and multiple

Nothing to report.

2.9 Agency

2.9.1 Hotel booking through websites

Another case very similar to the *SecretHotels2* dispute has been to the FTT. A company ran a website on which customers or travel agents could book hotel accommodation in other countries. If the company was acting as a principal, it was liable to UK VAT under TOMS. If it was acting as an agent, no VAT was due in the UK.

The FTT derived the nature of its task from the Supreme Court's decision in the earlier case: it should start with the agreements between the parties in order to identify their rights and obligations, then determine whether that supported a relationship of agent or principal, and then to consider whether this conclusion accorded with the economic reality of how the business operated.

The agreements were materially similar to those in the earlier case. The website company had fewer obligations than the hotels, but that reflected their relative market positions: the hotels were small, individual operators keen to obtain a share of the UK market, so the website could impose greater obligations on them. The fact that the customer might not know the correct legal entity with which the contract was concluded did not mean that the website was acting as a principal.

The appeal was allowed in respect of the contracts under consideration. However, there were other contracts that were not submitted, and some that were governed by foreign law. The Tribunal reached no conclusion on these, leaving them to the parties to come to an agreement.

First-Tier Tribunal (TC05447): *Hotels4U.com Ltd*

2.9.2 "Gig" economy

The "gig" economy is a new expression that describes methods of working that involve individuals taking on short-term assignments that are on the borderline between employment and self-employment. The issue was highlighted by an Employment Tribunal ruling that Uber drivers were entitled to workers' rights as employees, rather than the minimal protection available to self-employed contractors.

The Office of Tax Simplification has published a paper to promote discussion on how workers, engagers and platforms in the "gig economy" interact with the tax system. The paper considers matters including:

- individuals with multiple income streams;
- the involvement of engagers and whether employment taxes are due; and
- the differences between employment status for tax and employment rights.

The paper is a departure for the OTS, which normally comments on existing tax rules. It is intended to promote discussion and encourage identification of issues and possible solutions, including the design of a system that will help taxpayers pay the right amount of tax.

www.gov.uk/government/publications/the-gig-economy-an-ots-focus-paper

An article in *Taxation* considers the implications of the *Uber* decision and the consequences for tax, including the issue of VAT registration – if the workers are effectively employees of Uber, then Uber would normally be treated as making all the supplies of all the drivers, and the whole amount payable by the customer would be subject to VAT.

Taxation, 8 December 2016

2.10 Second hand goods

Nothing to report.

2.11 Charities and clubs

2.11.1 Updated Notice

HMRC have updated their Notice *Charity advertising and goods connected with collecting donations*, replacing the August 2003 version. The introduction states that it is simply updated with minor amendments.

Notice 701/58

2.11.2 Article

In an article in *Taxation*, Simon Shaw and Emma Bradley consider the implications for charities of recent case decisions on building projects, and the risk that the *Longridge on the Thames* judgment will lead to a 20% increase in costs of existing and planned projects.

Taxation, 1 December 2016

2.12 Other supply problems

Nothing to report.

3. LAND AND PROPERTY

3.1 Exemption

3.1.1 Craft fairs

HMRC have won their appeal to the Upper Tribunal in a case about fees for participation in craft fairs.

A sole trader organised craft fairs in and around Dorset. She charged stall holders for space to sell, and she charged entrance fees to the public. The stall fees were treated as exempt, while the entrance fees were treated as taxable.

In May 2013, HMRC wrote to the taxpayer to tell her that the stall fees were in reality for a "package of services" rather than purely for land, and they did not qualify for exemption. This decision was upheld after a review, and she appealed to the FTT (TC04428).

The taxpayer's counsel argued that the essential supply was simply of space. If there was any additional element, it was ancillary and incidental to the supply of land. HMRC's counsel responded that the essence of the supply was a licence to use land: the land, like food in the supply of restaurant services, is not ancillary but of central and indispensible importance to a single supply, namely the organisation of a craft or garden fair at which stallholders are able to exhibit their wares for sale.

The FTT examined the way in which the fairs were organised. The taxpayer hired marquees and other facilities such as portable toilets, and employed staff to act as ticket sellers and car park marshals. The advertising material to the stallholders included the following:

Our affordable stall prices and reasonable entrance charges ensure that you reap the financial rewards you deserve at a Craft Carnival fair. Everything we do is designed to make your experience of our events pleasurable and stress-free, as well as profitable. Your comments and suggestions are always welcome and, as ever, we will do our best to accommodate any special requirements you may have.

The contracts between the taxpayer and the stallholders were also considered in detail. This described the supply as "a licence to use a stall or pitch at the event specified overleaf ('the Show') to offer certain goods for sale."

The Tribunal considered precedents on economic reality, compound and multiple supplies, and the exemption for supplies of land, including *Sinclair Collis*. There were some very old Tribunal decisions about stall hire – *Tameside Metropolitan Borough Council* (VTD 733), *WB Enever* (VTD 1,537), *Miller Freeman Worldwide plc* (VTD 15,452), as well as *Southport Flower Show* (TC01938).

The judge was satisfied that the supply was, according to the contract and in reality, a licence to occupy land. It differed from *Enever* (where the taxpayer lost) because that involved only a supply of a table rather than a pitch; it differed from *Sinclair Collis* in that the taxpayer allocated a specific location to the stallholder for the duration of the fair. It would also be impossible for anyone else to use the same pitch during that period – in effect, the right to admit or exclude others had been granted.

HMRC argued that leasing or letting was essentially a passive activity, while the taxpayer added considerable value through her efforts in promoting and organising the events. The judge did not consider this to be a matter of principle that excluded such an operation from being a letting of land.

The appeal was allowed by the FTT. Shortly afterwards, HMRC won a very similar case (TC04538: *International Antiques and Collectors Fairs Ltd*), and they appealed this one to the Upper Tribunal. The issues were whether the taxpayer's contractual obligations extended beyond the mere supply of land to "the organisation of a craft fair", and if so, whether that was a compound supply that could not be exempt.

The Upper Tribunal noted that it was well established that the interpretation of a written contract depended on the intention of the parties, which could be derived not merely from the written words but also the context. This included:

(i) the natural and ordinary meaning of the clause;

(ii) any other relevant provisions of the lease;

(iii) the overall purpose of the clause and the lease,

(iv) the facts and circumstances known or assumed by the parties at the time that the document had been executed; and

(v) commercial common sense;

but subjective evidence of any party's intention should be disregarded.

The Upper Tribunal concluded that the proper construction of the contract included the obligation to provide a fair. The reference to "the Show" in the contract was not, as the FTT had concluded, merely the context in which a supply of land took place: it was fundamental to what the stallholders were buying. The taxpayer's activity was not the relatively passive supply of land, but extended to significant responsibilities that did not fall within the exemption.

Upper Tribunal: *HMRC v Kati Zombory-Moldovan*

HMRC guidance (VAT Notice 742, paras 2.6 and 2.7, and the VAT Land and Property Manual, VATLP05800 and VATLP05900) contains lists of supplies that they consider are, and are not, exempt licences to occupy land. Fairs and exhibitions have produced several different problems leading to case disputes. As HMRC have won several of these recently, it is possible that they may seek to widen further the types of supply that are standard rated. This case emphasises that it is necessary to interpret the written contract in its context, which means that what appears to be a mere supply of land may be regarded as something more.

3.2 Option to tax

3.2.1 Disapplication did not apply

A company acquired a former pub with planning permission to convert the ground floor into a children's day care nursery and the upper floor into residential flats. It paid £210,000 plus VAT for the purchase in March 2013. The purchase was financed by the owners of the company out of their own resources. The company registered for VAT in November 2013 and opted to tax the property. It granted a 15-year lease to a connected company to operate the nursery on 23 January 2014. The intention was that the rent was set at a market rate with five-yearly reviews. Works were carried out to the nursery and the flats at VAT-inclusive costs of £210,000 and £161,500 using external finance that had to be arranged after the acquisition. The nursery was completed on 30 June 2014, the flats on 12 September.

The company claimed a deduction in relation to the work on the nursery, but not on the flats. HMRC ruled that the anti-avoidance provisions of Sch.10 VATA 1994 applied: the option to tax was disapplied, because the company supplied the opted land to a connected person who would occupy it for exempt purposes.

Smith & Williamson had given advice in February 2014 to the effect that the anti-avoidance rules would not apply provided that the work was carried out in phases and no phase exceeded the CGS threshold of £250,000 excluding VAT. This was based on para.4.12 of Notice 706/2, which reads:

What if the refurbishment is in phases?

If you do this you will need to decide whether the work should be treated as a whole for CGS purposes or whether there is more than one refurbishment. If you think that each phase is really a separate refurbishment then they should be treated separately for CGS purposes.

Normally there is more than one refurbishment when:

- *There are separate contracts for each phase of work: or*
- *A contract where each phase is a separate option which can be selected; and*
- *Each phase of work is completed before work on the next phase starts.*

A refurbishment which is only undertaken in phases because the building is occupied and where the contractors work on one floor at a time is normally considered to be only one refurbishment.

HMRC contended that the costs of acquisition and development had to be aggregated – they were not "separate phases of development" that could be regarded individually. They argued that the whole cost, including that incurred on the residential flats, had to be taken into account in determining whether there was a capital item. They pointed to a number of factors that indicated the whole project was an indivisible whole. They also argued that it made no difference whether there was an avoidance intention (the taxpayer argued that the provisions were aimed at artificial

arrangements of banks); the company was not entitled to rely on a paragraph of a Notice, but was bound by the law.

The judge did not agree. She accepted that the Tribunal had no jurisdiction over legitimate expectations, but commented that the taxpayer would probably have a strong argument based on the wording of the Notice. She went on to state that she considered the anti-avoidance provisions should be applied purposively, noting that it is headed “anti-avoidance”.

She stated that the main question before the Tribunal was whether expenditure of different types can or should be aggregated for the purposes of the CGS. This is not clear in the legislation. In view of the separation by time and contract of the acquisition and the development, and the uncertainties of the availability of finance, the judge concluded that it was not appropriate to aggregate the costs. The provisions therefore did not apply, and the option to tax was valid.

The Tribunal went on to consider the relevance of the PVD and the authority for the UK’s disapplication rules. HMRC submitted that the rules were covered by a wide discretion to introduce an option to tax and therefore to restrict it as the Member State sees fit. The judge considered that restrictions were still subject to the objectives of art.131, to ensure the straightforward application of the exemptions and to prevent avoidance, evasion and abuse. In effect, the judge questioned the way in which the rules have been interpreted and operated by HMRC for many years, and some official response will be required in due course.

First-Tier Tribunal (TC05450): *Water Property Ltd*

3.2.2 Apportionment

On 2 June 2011 a couple bought the long lease of a pub with a sitting tenant. They opted to tax on 9 June and sent HMRC the notification on 10 June. HMRC acknowledged and accepted the option on 4 July, noting that it would not apply to residential parts of the property.

There were then difficulties with the tenant, who failed to pay rent and moved out. After trying various alternative uses, the couple sold the property for £52,500 on 17 September 2012. They failed to enter any output tax on the return for the 11/12 period. When HMRC questioned this, they claimed that the flat represented the whole value of the property at sale; HMRC contended that the apportionment should be 90% commercial, 10% residential.

The grounds of appeal included strong criticism of HMRC’s review process: evidence and argument put forward by the taxpayer had been ignored. HMRC appeared to be using an outdated standard apportionment ratio that was not applicable to this situation. This appeared to be derived from Notice 700/57 and an agreement between HMRC and the Brewers’ Society concerning the deductibility of input tax incurred by landlords on opted pubs. The internal manual at VATVAL 13420 contained the 90:10 split as a policy, based on research carried out by the Society.

The husband presented his research into the values of properties in the area and explained his criticism of HMRC’s approach. However, he was not an expert, and the Tribunal could not rely on his evidence because there were significant gaps and points that he could not explain.

The Tribunal identified four possible ways of apportioning the values:

(1) The presumption arising from the Brewers Society Agreement.

(2) The comparative capital values of the Flat and the Public House.

(3) The comparative rental yields of the Flat and the Public House.

(4) The comparative useable space of the Flat and the Public House.

The Tribunal preferred the useable space method, as the property had been vacant for some time at the date of sale and did not have the benefit of any tenant in either part. This led to an apportionment of 2/3:1/3 in favour of the commercial property, which had the benefit of the cellar and the beer garden. This was recognised as a broad-brush approach but the most appropriate in all the circumstances.

The appeal was allowed to the extent of reducing the assessment and a related default surcharge.

First-Tier Tribunal (TC05426): *David and Pamela Matthews*

3.3 Developers and builders

Nothing to report.

3.4 Input tax claims on land

3.4.1 Separate use

An individual constructed a bungalow and claimed £5,300 under the DIY Builders scheme. HMRC refused on the grounds that the planning consent imposed a restriction on use. The appeal was stood over behind the *Burton* case, and proceeded to the Tribunal in September 2016 after HMRC had won that case in the UT.

The disputed planning condition in *Burton* was that "The occupation of the dwelling shall be limited to a person solely or mainly employed or last employed in Park Hall Lake Fisheries or a widow or widower of such person or any resident dependants." The UT held that this constituted a restriction on separate use that was associated with a particular other piece of land, rather than a more general occupancy restriction to a class of persons such as "teachers" or "nurses".

The planning permission in the present case was worded in very similar terms, as the appellant also managed a fishery business. The Tribunal agreed with HMRC that it constituted a prohibition on separate use or disposal, and the appeal was dismissed. The connection with the business also ruled out a DIY claim, because s.35 requires that the carrying out of the works was not in the course or furtherance of any business.

First-Tier Tribunal (TC05462): *Thomas H Heckingbottom*

A similar argument was considered in relation to a barn conversion where the permission restricted occupation to persons solely or mainly employed in the equestrian enterprise at the site. The Tribunal examined the precedents and the arguments, and noted in particular the reasoning given

in the planning consent. It was plain that the local authority did not intend to permit the construction of a dwelling which could be occupied other than as ancillary to the business carried on at the location, and that amounted to a prohibition on separate use. The appeal was dismissed.

First-Tier Tribunal (TC05519): *Peter Boggis*

3.4.2 Rate of VAT

An individual claimed under the DIY scheme in relation to a barn conversion. HMRC refunded some VAT at 5% instead of the 17.5% paid to the builders, and refused some other items altogether either because they were outside the scope of the scheme or proper invoices had not been provided. The total in dispute was £24,400. £7,755 was paid by HMRC, i.e. under 25% of the amount claimed.

The disallowed items included consulting on a steel framework, a Jacuzzi, a conservatory and under-floor heating, boiler and heating equipment. Building works, electrical works, carpentry and flooring were all accepted in principle, but some of the invoices were not made out in the appellant's name, and some had been charged at 17.5% when HMRC considered they qualified for the reduced rate.

The judge agreed with HMRC that there is no basis for a DIY claim in respect of consultants or for VAT incurred by a third party, even if reimbursed by the claimant. The rate at which VAT should be repaid is the proper rate that should have been charged; up to September 2006, the suppliers would not have known that the project would turn into a qualifying conversion, so it was proper for them to charge 17.5%. After that, the 5% refund was correct, and it would be up to the appellant to negotiate with his suppliers. The judge noted that the suppliers would be out of time to make an adjustment with HMRC, and noted that she had not considered whether there would be any basis for a civil claim or a claim under EU law for the refund.

HMRC agreed to examine some extra invoices submitted in relation to the Jacuzzi, and the judge held that the conservatory was a valid part of the project. The appeal was therefore allowed in part.

First-Tier Tribunal (TC05510): *Charles Denis Smith*

3.5 Other land problems

Nothing to report.

4. INTERNATIONAL SUPPLIES

4.1 E-commerce

4.1.1 Exchange rates

HMRC have published the usual table of exchange rates for traders registered under MOSS during the quarter to September 2016.

VAT Information Sheet 5/2016

4.2 Where is a supply of services?

4.2.1 Greenhouse gas allowances

A pair of tax advisers were prosecuted for involvement in a VAT fraud carried on by a client in 2009 and 2010. They had prepared corrected VAT returns for a client company on the basis that certain supplies of greenhouse gas emissions allowances were subject to VAT in Germany. This was incorrect if those allowances were "similar rights" within art.56(1)(a) PVD and therefore subject to tax where the customer belonged. The advisers argued that they were not, and questions were referred to the CJEU.

The CJEU considered the purpose of the provision and concluded that emissions allowances were "similar rights". The decision is of historical interest only (although of particular interest to the two advisers), because emissions allowances are now subject to specific rules to prevent the type of fraud carried out in this case.

CJEU (Case C-453/15): *Criminal proceedings against A, B*

4.2.2 Fixed establishment

A UK company and a Jersey company were involved in providing the service of arranging name changes by deed poll for UK individuals. The customers contracted with the Jersey company, which treated its services as outside the scope of UK VAT; much of the work was sub-contracted to the UK company, which also treated its supplies as outside the scope of VAT, as they were supplied to the Jersey company. HMRC ruled that the Jersey company had a fixed establishment in the UK and was therefore liable to VAT (and the UK company's supplies would also become liable to VAT). The total amount of VAT in dispute was over £1m, together with a "careless inaccuracy" penalty.

The deed poll business had been carried on for several years by the UK company before being sold to a Liechtenstein trust in June 2010. The business was then transferred to the Jersey company, incorporated for the purpose, and the former owner was engaged under the terms of the sale agreement to carry on various activities for the company for the next two years. This arrangement came to an end in October 2013 when the business was transferred to another company owned by the same individual, which has since then been based in the UK and has charged VAT on all its supplies.

The director travelled to Jersey during the working week. He was the only person able to change the content of the company's websites, and he authorised all transactions, although in some cases urgent applications were processed first and checked later. Two members of staff gave evidence to support this, although they also accepted that there was little difference between the way the business operated before and after the Jersey company took it over.

The companies argued that the contractual position was that the Jersey company contracted with the customers to make the supply, and the UK company only provided services to the Jersey company. The Jersey company had an office there with the necessary degree of permanence and resources to make the supplies. The company argued that the CJEU cases of *DFDS* and *RAL (Channel Islands) Ltd* were not relevant: *DFDS* had concerned a parent and subsidiary, and *RAL* had concerned a completely different provision of the Directive. The fact that the customers would not notice a difference in the way the business was carried on had been rejected as irrelevant by Warren J in the *Newey* case.

HMRC argued that the reality was that the two businesses were so closely linked that the UK operation was a fixed establishment of the other. The only input from Jersey was the managing director's supervision: everything else happened in the UK. The websites suggested that the service would be provided from a base in the UK, as postal applications had to be made to Essex, and customers could also call there in person.

Judge Bishopp noted that the companies' argument based on the contracts was misplaced: it did not answer the question of whether the Jersey company had a fixed establishment in the UK. The judge was satisfied that the Jersey company could not have made any supplies to customers without the Essex office, which surely meant that the Essex office was a fixed establishment – it provided the human and technical resources by which supplies were made. In the terms used in the *DFDS* case, the UK company was the "auxiliary organ" of the Jersey company.

The appeals were dismissed.

First-Tier Tribunal (TC05506): *Multimedia Computing Ltd and another*

4.3 International supplies of goods

4.3.1 Substantive conditions for exemption

In 2006 a German trader acquired a vehicle for his business. In October 2006, he despatched the vehicle to a dealer in Spain with a view to selling it. There was a consignment note to evidence the movement of the goods. In July 2007, the vehicle was sold to a Spanish business. The dealer did not declare any turnover for 2006 in respect of the vehicle, but included an exempt intra-community sale in 2007. The German authorities decided that the conditions for exemption had not been met, and issued an assessment.

On further investigation, the authorities decided that it was the 2006 despatch that did not qualify for exemption, because no Spanish VAT number had been supplied to validate an exempt movement. The original assessment was cancelled and replaced. On appeal, the German court decided to refer questions to the CJEU. There appeared to be no VAT avoidance or evasion: the trader had made an error in recording the transactions. Was it appropriate to deny exemption when the substantive conditions appeared to have been met?

The CJEU replied that it was not. Where there was no evidence or allegation of participation in tax evasion, denial of exemption was disproportionate where there was evidence that the goods had left the country and the other substantive conditions were satisfied.

CJEU (Case C-24/15): *Josef Plockl v Finanzamt Schrobenhausen*

4.3.2 Exemption on importation

The Italian Supreme Court has referred questions to the CJEU on the conditions for the exemptions on importation of goods to apply. It appears that Italian law only exempts ancillary transport services if the import is actually subject to import VAT and customs duty is paid, whereas the referring court appears to believe that art.144 and art.86(1) PVD, read together, require exemption to apply in any situation in which the value of the ancillary inbound transport service is included in the taxable amount of the goods (regardless of whether they were subject to import VAT or customs duties).

CJEU (Reference) (Case C-273/16): *Agenzia delle Entrate v Federal Express Europe Inc*

4.3.3 Evidence of export

A wholesaler of tyres appealed against an assessment for £125,145 for the periods 12/11 to 06/13. Penalties of £25,263 were also charged. The trader had taken over the business she had previously been employed by in August 2011. The majority of sales were treated as zero-rated despatches of tyres to the Republic of Ireland, but she did not keep documentary evidence of the movement of goods. It appeared that she did not understand the requirements, nor the correspondence from HMRC, but relied on her accountants. HMRC visited the premises for the first time in March 2013 and spent much of the rest of the year asking for more information from the trader and the accountants but without success.

The trader's representative argued that the trader's records showed the VAT numbers of the customers, and HMRC should use the mutual assistance procedure to verify the exports. This was, in his view, a case where the transactions were genuine and there was a mere failure to complete paperwork. He made the surprising assertion that Notice 725 would only have effect if HMRC had drawn it to the trader's attention.

The Tribunal judge was wholly unconvinced, agreeing with HMRC that the trader had failed to satisfy the applicable legal requirements and was not entitled to zero-rating. The appeal was dismissed.

First-Tier Tribunal (TC05433): *Angela McCamley*

4.3.4 Free zones

German law provides that certain free zones are treated as "foreign territory", so for the purposes of German law they are not in the EU. Questions were referred to the CJEU about the consequences of this rule for import VAT.

The context was a situation in which goods arriving at Frankfurt airport had been sealed and entered into the external Community transport procedure, en route for the free zone at Hamburg. However, they were not presented to the customs office there; an investigation suggested that they had been unsealed and unloaded in the free zone and sent by sea to Finland and on to Russia. The authorities assessed both the principal and the transporter, but only sought payment from the transporter, which was the party that had failed to complete the transit procedure. The transporter argued that the removal of the seal in a free zone did not incur a liability to import VAT, even if it did incur a customs debt.

The questions sought clarification of the relationships between the various rules on tax points in articles 61, 71 and 156 of the PVD and articles 203 and 204 of the Customs Code. The Advocate-General's opinion is that free zones are an "arrangement or situation referred to" in art.156 PVD, and it is therefore possible for no VAT debt to be triggered when goods are unloaded there.

The second question was whether the VAT debt would be automatically incurred at the same time as the customs debt when the goods left customs supervision (by the failure to complete the transit procedure), so triggering a customs debt under art.203 of the Code. The A-G's opinion is that the VAT debt would be incurred, even though the goods were in a free zone at the time, if it is reasonable to presume that the goods were able to enter the economic network of the EU. It would be for the national court to determine that.

The A-G also opined that articles 203 and 204 of the Customs Code are mutually exclusive. If a customs debt has been incurred under art.203, but in the circumstances of the case no VAT debt has been incurred because the goods were in a free zone, then art.204 could not be used on its own for the sole purpose of providing a basis for charging VAT.

CJEU (A-G) (Case C-571/15): *Wallenborn Transports SA v Hauptzollamt Gießen*

4.3.5 Small consignments

The Value Added Tax (Small Non-Commercial Consignments) Relief (Amendment) Order 2016 increases the value limit for relief from VAT on small non-commercial consignments from 1 January 2017 from £34 to £39. This is because the limit is stated in euro (€45) and the rate of exchange has moved. The relief is given by SI 1986/939, which the current order amends.

SI 2016/1199

4.3.6 Updated Notice

HMRC have updated their Notice *The single market*. It has been revised to reflect the VAT registration numbers in other Member States arising from the introduction of Croatia with effect from 1 July 2013 and changes to Irish numbers.

Notice 725

4.3.7 Fit and proper conditions

The *Value Added Tax (Amendment) Regulations 2016*, which came into force on 7 November 2016, enable HMRC to refuse to register a VAT representative appointed by a non-EU trader, and to cancel a registration, if they do not consider the VAT representative to be a fit and proper person to act in that capacity. The regulations are made under a power introduced by FA 2016 and form part of a package of measures to tackle VAT evasion by overseas businesses using online marketplaces. The amendments are made to the rules in SI 1995/2518 reg.10.

The explanatory notes to the regulations say that the abuse of the rules by overseas businesses in this area costs the UK exchequer between £1 billion and £1.5 billion each year.

SI 2016/989

4.3.8 Simplified IPR

HMRC have issued a paper to set out the correct procedure for claiming import VAT on entries to inward processing using the authorisation by declaration procedure (before the introduction of the Union Customs Code, this was known as “simplified IPR”). Import charges are usually secured by a deposit or a guarantee, but deposit is more usual for this procedure.

HMRC have become aware that some importers are claiming the deposit amount as input tax. This is incorrect. Discharge of the IPR will lead to repayment of the deposit; if the goods are imported, or the IPR is not discharged, a C79 will be issued and input tax can be claimed at that time.

Customs Information Paper 62/2016; www.gov.uk/government/publications/customs-information-paper-62-2016-reclaim-of-import-vat-regarding-entries-made-to-authorisation-by-declaration-simplified-inward-processing

4.4 European rules

4.4.1 Commission proposals

The European Commission has presented proposals to improve e-commerce for EU traders, particularly small and start-up businesses. These include:

- extending the VAT one-stop-shop to online sales of all goods and services;
- allowing application of domestic rules to annual sales under €10,000 and simpler rules for cross-border sales of services up to €100,000 annually;
- removal of small consignments relief; and
- alignment of VAT rates on e-publications with their print equivalents.

The extension of the one-stop-shop is supposed to reduce VAT compliance expenses for traders by €2.3 billion a year, but will also stop revenue losses to Member States estimated at €5 billion a year. This figure is expected to rise to €7 billion by 2020 if action is not taken.

The threshold for digital sales is expected to simplify trading for 430,000 companies across the EU, representing 97% of those businesses that trade cross-border. The higher limit will be applied to SMEs who will apply simplified rules in determining where their customers are based.

The removal of the small consignments relief will prevent unfair competition from outside the EU, which extends not only to genuine small consignments but also higher value items that are misdescribed as benefiting from the exemption (at €22).

Lastly, Member States are to be given permission to apply the same lower rates to digital publications as they use for printed matter.

europa.eu/rapid/press-release_IP-16-4010_en.htm

4.4.2 Consultation on tax avoidance schemes

The European Commission is consulting until 16 February 2017 on introducing more effective disincentives for tax advisers and other intermediaries engaged in the promotion of aggressive tax avoidance schemes. The consultation, in the form of an online questionnaire, seeks views on criteria for classifying "aggressive" tax planning and how to put in place a mandatory disclosure scheme for tax advisers.

europa.eu/rapid/press-release_IP-16-3618_en.htm

4.4.3 Commission work programme

The European Commission has issued its 2017 work programme. This is a wide-ranging document in which VAT only features in a number of minor areas. These include the "connected digital single market", where the Commission refers to the "VAT REFIT package" covering proposals on e-commerce, e-publications and e-books; and the VAT Action Plan, to simplify VAT for smaller companies and set the foundations for a modern, more efficient, business-friendly and fraud-proof definitive VAT

regime across Europe, taking account of the opinions of the REFIT Platform. A more effective and proportionate approach to VAT rates is a key element of this reform. This is set against the background of the continuing €50 billion annual cost of VAT fraud.

http://ec.europa.eu/atwork/pdf/cwp_2017_en.pdf

4.4.4 Business splitting?

Three family partnerships managed vineyards, and the members jointly owned a limited company that purchased wine from them and sold it to retailers. Each partnership leased a vineyard, owned equipment and employed workers. The Austrian authorities considered that there was a single taxable person, and questions were referred to the CJEU.

The Court ruled that civil law partnerships which conduct themselves outwardly as such and independently in relation to their suppliers, public authorities and, to a certain extent, their customers, and each of which carries out its own production by using for the most part its means of production, but which market a large proportion of their products under a common trade mark through a limited company the shares in which are held by members of those civil-law partnerships and by other members of the family in question, must be regarded as independent undertakings which are taxable persons for VAT purposes.

The Court then ruled that Austria would be entitled to exclude these partnerships from the operation of the Agricultural Flat Rate Scheme, if they were assessed as materially capable of operating the normal VAT accounting procedures by reason of their size and resources. The FRS was supposed to be directed at operators who would find it excessively difficult or costly to comply with the normal rules; if that was not the case, it was reasonable for the Member State to exclude them, even if they were not included in a class of traders excluded by the law. If it was appropriate to exclude them from the FRS, this could be made retrospective, provided that the time limit for making such assessments had not expired.

CJEU (Case C-340/15): *Christine Nigl and others v Finanzamt Waldviertel*

4.4.5 Racing success?

A horse trainer operated stables. She derived income from prizes earned in races by her own horses and her share of prizes earned by other owners' horses that she trained, and also from charging owners for training their horses. She claimed full deduction of input tax on all her expenditure, even though the prize money was treated as outside the scope of VAT, and applied a 10% reduced rate to the charges for training horses. The Polish authorities disputed these two benefits, and questions were referred to the CJEU.

The Court ruled that providing a horse for a race was not a supply for consideration if payment was entirely dependent on the horse winning (or achieving a high ranking). If "appearance money" would be paid regardless of placement, there would be a supply for consideration. Prizes should not be included in VATable turnover.

Nevertheless, input tax could be deducted on all expenditure relating to the operation of the stables, provided that those expenses had a direct and immediate link with the overall economic activity. That could apply if it related to preparation of horses for sale, or if entry for races promoted the overall economic activity.

There is some interesting analysis of the difference between a "direct" and an "indirect" link: "*the fact that the transactions linked to the preparation of the horses belonging to the operator of the stables for races and their participation in those races would enable him to improve and develop the training methods, feed and care given to the horses, and thus the services provided to other owners, is irrelevant for the purposes of that assessment. Such a fact merely reflects an indirect link between those transactions and the economic activity at issue in the main proceedings... Furthermore, if the transactions linked to the preparation for races of the horses belonging to the operator of the stables and the participation of those horses in races are intended to promote the private interests of that operator, those transactions cannot be regarded as having a direct and immediate link with the overall economic activity consisting in the operation of such stables.*"

The reduced rate was claimed for "use of sporting facilities" which is included at point 14 of Annex III PVD (and the Polish equivalent law). The Court observed that the context for this VAT relief is the desire to encourage participation in sport, which is very different from the training of racehorses. It would be for the national court to determine whether "use of sporting facilities" represented to any extent an independent supply worthy of the application of the lower rate, but if there was a composite supply of training, stabling, feeding and other care of horses, it would be most likely standard rated in its entirety.

CJEU (Case C-432/15): *Odvolací finanční ředitelství v Pavlína Baštová*

4.4.6 Missing transactions

A Bulgarian trader was investigated by the authorities, who discovered purchase invoices from suppliers that were not recorded in his accounts and on which he had not deducted input tax. They assumed that he had actually received these goods and sold them, and assessed him to output tax based on a comparable margin earned on similar products. He disputed whether they were entitled to make this presumption, and questions were referred to the CJEU.

The Court ruled that Member States have a margin of discretion in the measures they adopt to prevent avoidance and evasion of VAT. Provided that the national court was satisfied that the measures taken went no further than was necessary to restore the position that would have subsisted in the absence of avoidance or evasion, the PVD did not prohibit presumptions such as those that were made in the present case.

CJEU (Case C-576/15): *ET 'Maya Marinova' v Direktor na Direktsia 'Obzhalvane i danachno-osiguritelna praktika' Veliko Tarnovo pri Tsentralno upravlenie na natsionalnata agentsia za prihodite*

4.4.7 Separate supplies?

A Hungarian commercial company entered into contracts with a number of farmers to provide them with finance, goods and services. It supplied materials and equipment, and also facilitated their sales of produce. The company provided loans that the farmers used to buy the goods, and separately charged interest on the loans. The Hungarian authorities took the view that the loans were not separate from the supply of goods and assessed for VAT on the interest. Questions were referred to the CJEU.

The Court noted that decisions on what constituted a single supply or multiple supplies were properly to be taken by the national courts. However, in order to provide a helpful answer, it examined the question in full and concluded that this integrated operation should be regarded as a single transaction in which the supply of goods was the principal supply. The "interest" was part of the consideration for the goods and would be taxable as such. The fact that the "integrator" (the Hungarian term for such a company) might also provide the farmer with additional services or buy the produce had no bearing on the categorisation of the transaction as compound.

CJEU (Case C-208/15): *Stock '94 Szolgáltató Zrt. v Nemzeti Adó- és Vámhivatal Dél-dunántúli Regionális Adó Foigazgatósága*

4.4.8 Reverse charge

Art.199(1) PVD permits Member States to impose a reverse charge mechanism on certain supplies. In particular, subpara.(g) refers to "the supply of immovable property sold by a judgment debtor in a compulsory sale procedure". The Hungarian authorities imposed a VAT liability and a penalty on a trader who bought a "mobile hangar", and questions were referred to the CJEU.

The A-G has given an opinion that art.199(1)(g) can only apply to immovable property, whereas a "mobile hangar" seems likely to be moveable (although the order for reference did not make this clear, nor was there a distinction between the two in the Hungarian law). There was no authority in the PVD for imposing a reverse charge mechanism on the purchaser of moveable property from a judgment debtor.

The A-G goes on to give some guidance on what ought to happen if, unexpectedly, the mobile hangar turns out to be immovable property. The tax authorities appeared to be requiring the trader to pay the reverse charge without allowing the corresponding deduction, and imposing a fine without alleging any fraud or evasion. This would be incorrect and disproportionate.

CJEU (A-G) (Case C-564/15): *Tibor Farkas v Nemzeti Adó- és Vámhivatal Dél-alföldi Regionális Adó Főigazgatósága*

4.4.9 Reduced rate

A company supplied oxygen concentrators and accessories for oxygen treatment. The Belgian authorities considered that this was a standard rated supply; the company argued that it should be entitled to use a reduced rate of 6% for medical or pharmaceutical products, which is applied to medical oxygen in tanks. Questions were referred to the CJEU.

The A-G has given an opinion that the concentrators were not "pharmaceutical products" under the third item of Annex III. They could therefore only qualify under the fourth item, which required them to be for the relief of disability. Although some of the patients might fit that description, some would not. This meant that they could not fall under either heading.

The A-G also considered that the principle of fiscal neutrality could not be applied to extend the categories and allow lower rating of these devices on the basis that oxygen in tanks did qualify. The principle could not override the clear wording of the law.

CJEU (A-G) (Case C-573/15): *État belge v Oxycure Belgium SA*

4.4.10 Works of construction

The French Supreme Court has referred questions to the CJEU on whether the sale and installation of photovoltaic panels and solar water heaters on buildings, or with a view to supplying electricity or hot water to buildings, constitute a single transaction that may be characterised as works of construction for the purposes of what are now articles 14(3) and 24(1) PVD. The point is that "the handing over of certain works of construction" may be regarded as a supply of goods rather than a supply of services, and would therefore be subject to slightly different VAT rules.

CJEU (Reference) (Case C-303/16): *Solar Electric Martinique v Ministre des finances et des comptes publics*

4.4.11 Personal exports

The Polish court has referred questions on the lawfulness of a law which restricts the application of the exemption for exports where a taxable person has not satisfied a condition relating to attaining a qualifying level of turnover in the preceding year, and has also not concluded an agreement with a person who is authorised to refund tax to travellers.

CJEU (Reference) (Case C-24/15): *Stanisław Pieńkowski v Dyrektor Izby Skarbowej w Lublinie*

4.4.12 Ancillary transport

The Latvian court has referred questions about the exemption for "the supply of services, including transport and ancillary transactions, but excluding the supply of services exempted in accordance with Articles 132 and 135, where these are directly connected with the exportation or importation of goods covered" in art.146(1)(e) PVD. The first question is whether the exemption only applies where there is a direct legal connection or reciprocal contractual relationship between the service provider and the consignee or consignor of the goods, and the second question asks for clarification of the conditions for such a connection to qualify for exemption.

CJEU (Reference) (Case C-288/15): *IK 'L.Č.'*

4.4.13 Second-hand buildings

The Polish court has referred questions to the CJEU about the operation of art.135(1) PVD, which provides that supplies of buildings are exempt except in specific limited circumstances. The Polish law includes a sale within 2 years after an upgrade costing at least 30% of the initial value of the building, which appears to be the possible point of departure from the Directive.

CJEU (Reference) (Case C-308/16): *Kozuba Premium Selection sp. z o.o., established in Warsaw, v Dyrektor Izby Skarbowej w Warszawie*

4.4.14 Invoice requirements

The German court has asked the CJEU to rule on the requirement for a "full address" in an input tax invoice: in particular, whether it is acceptable for the supplier to give a postal address, which is valid for postal contact but where the supplier does not carry on any economic activity. The questions also ask for consideration of a national practice which takes into account "good faith on the part of the recipient of the supply in the satisfaction of the requirements for the right to deduct input tax only outside the tax assessment procedure, within the framework of a special equitable procedure". Exactly what this means may become clearer when the full judgment is available.

CJEU (Reference) (Case C-374/16): *RGEX GmbH, in liquidation, represented by Rochus Geissel, liquidator v Finanzamt Neuss*

4.4.15 Non-payment and input tax

The Slovenian court has referred questions to the CJEU about the proper treatment of input tax deduction in circumstances where the debtor has made a court-approved arrangement with creditors and has therefore not paid the full amount invoiced. The questions ask for consideration of the proper application of articles 184 to 186 PVD in such circumstances.

CJEU (Reference) (Case C-396/16): *T — 2, družba za ustvarjanje, razvoj in trženje elektronskih komunikacij in opreme, d.o.o. (currently in a state of insolvency) v Republika Slovenija*

4.4.16 TOMS in Germany

The Commission has taken infringement proceedings against Germany, arguing that it is in breach of the PVD by allowing travel services used by taxable persons to be excluded from the margin scheme, and by allowing travel agents to apply a flat rate to groups of services supplied over a period, rather than calculating the VAT separately for each journey.

CJEU (Reference) (Case C-380/16): *Commission v Federal Republic of Germany*

4.4.17 Appropriate measures

Member States are supposed to take necessary measures to prevent VAT evasion and ensure effective punishment of those who commit it. The Bulgarian court has referred questions to the CJEU on whether phone tapping, which was carried out on the basis of a number of procedural irregularities, was compatible with this rule, given that the evidence

contained was crucial in determining that the subject was guilty of the offence.

CJEU (Reference) (Case C-310/16): *Criminal proceedings against Petar Dzivev*

4.4.18 Sale before despatch

The Lithuanian court has referred questions about a situation in which goods have been ordered by a purchaser in another Member State who has declared an intention to sell the goods immediately to a person in a third Member State before the supply transaction or the transport out of the first Member State. This seems to be a situation in which the PVD would require the customer to register in Lithuania to receive a domestic supply and make a despatch.

CJEU (Reference) (Case C-386/16): *UAB 'Toridas' v Valstybinė mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos and Kauno apskrities valstybinė mokesčių inspekcija*

4.4.19 Interest on overpayments

The Lithuanian court has referred questions about the effect of fiscal neutrality on national laws concerning interest repayable to a trader on a VAT overpayment that was not repaid at the correct time. This may be relevant to the disputes about interest on VAT repayments in the UK, although it seems likely that those cases will be heard by the Supreme Court before this case is heard by the CJEU.

CJEU (Reference) (Case C-387/16): *Valstybinė mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos v Nidera B.V. and Vilniaus apskrities valstybinė mokesčių inspekcija*

4.4.20 More reverse charges

The Romanian court has referred a question about the mandatory imposition of a reverse charge on a trader who has been compulsorily registered following an investigation. The court seems to be in doubt as to whether the fact that the trader was not registered affects the mandatory nature of a reverse charge.

CJEU (Reference) (Case C-392/16): *Marcu Dumitru v Agenția Națională de Administrare Fiscală (ANAF), Direcția Generală Regională a Finanțelor Publice București*

The Bulgarian court has referred questions about the possibility of distinguishing between traders registered under different parts of art.214 PVD in relation to their right to deduct input tax. In particular, the questions refer to a trader who is registered under art.214(1)(e), which relates to traders making supplies to registered customers in other Member States on which the customer is required to account for output tax (i.e. a trader who never accounts for output tax in Bulgaria); it appears that the Bulgarian law precludes an input tax claim on reverse charges in that circumstance, because the question asks whether that is permissible.

CJEU (Reference) (Case C-507/16): *'Entertainment Balgaria System' EOOD v Direktor na Direktsia 'Obzhalvane i danachno-osiguritelna praktika' — Sofia*

4.4.21 Adjustment of consideration

The Hungarian court has referred questions about the compatibility of national legislation with the PVD where a lessor has terminated a lease because of breach of contract by the lessee. Art.90 provides for adjustment of consideration in various circumstances, including "refusal"; the Hungarian court seeks clarification of whether that applies, and whether the national law is allowed to rule out an adjustment to consideration in this situation.

CJEU (Reference) (Case C-404/16): *Lombard Ingatlan Lízing Zrt. v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatóság*

4.4.22 Intention and evidence

The Romanian court has referred questions to the CJEU about the right to deduct input tax on imported goods where the authorities do not consider that there is objective evidence to confirm a declared intention to use the goods for taxable transactions. It seems that the authorities imposed additional conditions such as evidence of actual use, and the questions seek to determine whether this is compatible with the PVD.

CJEU (Reference) (Case C-441/16): *SMS group GmbH v Direcţia Generală Regională a Finanțelor Publice a Municipiului București*

4.4.23 Different rates for single supply

The Netherlands court has referred questions about the possibility of applying different rates to identifiable parts of something that constitutes a single supply of services under general principles.

CJEU (Reference) (Case C-463/16): *Stadion Amsterdam CV; other party: Staatssecretaris van Financiën*

4.5 Foreign refund reclaims

4.5.1 Making supplies in the UK?

An Italian company arranged an enclosure at the Farnborough Air Show to be made available to fellow Italian subsidiary companies. The subsidiaries invited customers, potential customers and the press to the enclosure. The arranging company incurred VAT on related costs and claimed it back from HMRC under the 8th Directive and the Refund Directive.

HMRC argued that the claimant company was making a supply in the UK – it was the service of organising an exhibition or a fair, which until 1 January 2011 was supplied where the exhibition took place. The company argued that it was supplying a marketing or advertising service, which would have been supplied in Italy where the supplier was established (up to 31 December 2009) or in Italy where the customers were established under the normal B2B rule (from 1 January 2010).

The FTT (TC03364) considered precedent cases including *Gillan Beach* and *Inter-Mark*. It concluded from the reasoning of the CJEU in those cases that the categories of art.9(2) 6th Directive were intended to be mutually exclusive: a supply could not fall under more than one heading. If something was “advertising”, it could not also be regarded as “event organising”. The judge went on to state that:

I have no doubt that the services which FGS supplied to its sister companies were: (1) designed and used for the purposes of the dissemination of messages intended to inform potential buyers of the existence or quality of the products offered by those companies with a view to increasing the sales of such products, and (2) formed an inseparable part of the centrally coordinated advertising campaigns of the group companies by contributing to and conveying their marketing messages: the presence at the enclosure of employees of the group companies indicated that integration. As a result, because of the mutual exclusivity of the nature of the services described in the Article 9(2) provisions, the supply cannot fall within Art 9(2)(c) ‘events’. Therefore the place of supply falls to be determined under the applicable general rule, and is Italy.

In case he was wrong about the mutual exclusivity of the art.9(2) categories, he went on to consider whether the supply could also fall within art.9(2)(c). He set out what he regarded as the main features of an art.9(2)(c) supply, which included a complex service organising an event which would be attended by a number of people, including many final consumers. He concluded that this was not a correct description of what this appellant did – it made a more limited supply to businesses within the context of an event organised by someone else.

The appellant failed to overturn a separate HMRC decision to disallow two claims for VAT on specific expenses. One was held to be an advertising service on which no UK VAT should have been charged to an Italian customer; the second was not supported by a VAT invoice, and the Tribunal declined to exercise a supervisory jurisdiction to override HMRC’s decision to disallow. It could not be said to be an unreasonable decision.

HMRC appealed to the Upper Tribunal. The Upper Tribunal decided that the FTT erred in law in deciding that the categories in art.9(2) were mutually exclusive. Something that could be described as "advertising services" could also fall within the exception for fairs. The correct approach was to consider the precedent cases on fairs (*Dudda, Gillan Beach, Inter-Mark*) and conclude whether they indicated that this kind of activity was within them. In accordance with the CJEU decision in *Gillan Beach*, the airshow did not have to have a particular "theme" for the fairs exception in art.9(2)(c) to apply.

The FTT had been wrong to impose an additional criterion for the fairs exception to apply, over and above those contained in the *Gillan Beach* decision at paras.23 and 24. It was not essential for all of those receiving the company's services to be final consumers who bore the cost of the tax themselves. The crucial point was that the company was making supplies to people who received them at a particular location. It was easy to identify the place at which the supplies were made: the place of supply was where they were physically carried out within art.9(2)(c). The company was therefore making supplies in the UK, and was not eligible to claim a refund under the intra-community procedures.

The company appealed to the Court of Appeal, which essentially agreed with the reasoning of the Upper Tribunal. The correct approach for the court was to identify the "best fit" in art.9, rather than applying the categories in any priority order. The company provided bespoke services that were specific to an event made at a particular time and location, and it satisfied the conditions necessary for an art.9(2)(c) supply. The appeal was dismissed.

Court of Appeal: *Finmeccanica Global Services SpA (formerly Finmeccanica Group Services SpA) v HMRC*

5. INPUTS

5.1 Economic activity

5.1.1 Overheads

Durham Cathedral is the representative member of a VAT group comprising two companies. Its economic activities include the operation of a cafeteria/restaurant and gift shop, and it charges for admission to concerts (but not in general to the cathedral at other times). It also carries on the non-economic activity of religious observance in the cathedral.

The company incurred VAT of £6,720 on repairs to a bridge that connects the area of land on which the cathedral stands with part of the city to the south-west. The cathedral stands on a peninsular formed by a loop of the River Wear, and this is one of four bridges that provide access.

The Tribunal noted that the bridge formed an important part of what is designated as a World Heritage Site. Not everyone using the bridge would use it for access to the cathedral, and not all those that did so would use the economic facilities. The Tribunal decided that the cost of repairing the bridge was an overhead of the cathedral, that is, referable to all of its activities both economic and non-economic, and therefore deductible in part.

In 2009 the cathedral had agreed a partial exemption special method with HMRC that started with an apportionment of non-specific expenditure to 35% non-business and 65% business. The decision does not consider the exempt/taxable part of the PESM. When this was agreed, HMRC directed that a number of categories of expenditure should be regarded as non-business, including the maintenance of the river banks and bridges. The cathedral complied with this direction, but in 2015 wrote to claim a deduction in relation to expenditure 4 years before on the Prebends' Bridge on the basis that the *Sveda* case suggested that it should be partially deductible.

The Tribunal quoted at length from the A-G's opinion and full court judgment in *Sveda*, noting points of difference but dismissing them as not significant. Expenditure on the site had to be linked to all the activities or to none of them: it was not possible to sustain HMRC's view that the repairs to the bridge could be linked only to non-business activities. The physical distance of the bridge from the cathedral was also not particularly relevant. The key extract from *Sveda* is: "*a taxable person also has a right to deduct even where there is no direct and immediate link between a particular input transaction and an output transaction or transactions giving rise to the right to deduct, where the expenditure incurred is part of his general costs and are, as such, components of the price of the goods or services which he supplies. Such expenditure does have a direct and immediate link with the taxable person's economic activity as a whole*."

The appeal was allowed.

First-Tier Tribunal (TC05477): *Durham Cathedral*

5.2 Who receives the supply?

Nothing to report.

5.3 Partial exemption

5.3.1 Incidental financial transactions

Mercedes Benz Italia SpA is a holding company responsible for strategic direction of the international company's products in Italy. Among its activities is making loans to its subsidiaries; the interest on these loans represented over 70% of its turnover during the period under review. The company had regarded the interest as "incidental" and therefore to be excluded from the turnover-based partial exemption apportionment of recoverable input tax. The Italian authorities disagreed, and questions were referred to the CJEU, partly on the operation of the rules in the Directive, and partly on whether the Directive had been correctly transposed into Italian law.

The judgment contains a very detailed analysis of how the various alternative methods of partial exemption calculation in articles 17 and 19 6th Directive interact with each other. The conclusion is that the law requires a turnover-based method of apportionment for overhead input tax in general; an argument by the company that the turnover method only applies to VAT on transactions that are used to make both taxable and exempt supplies (as opposed to "overheads", that are not specifically used to make any supply) was rejected.

The key issue of broad relevance is what is to be regarded as "incidental" for the purposes of the partial exemption rules. The court ruled that the scale of a financial receipt (i.e. the 70%) was a relevant factor, but it was not conclusive. It was possible for a very large financial transaction still to be incidental, as held in the *EDM* case. The questions were whether the activity giving rise to financial income was a "direct, permanent and necessary extension of the business", and whether it did or did not entail a significant use of inputs subject to VAT (*EDM*, *Regie-Dauphinoise* and *NCC Construction Danmark*). Unusually, the judgment does not specifically state that "it is for the national court to determine whether that is the case", but presumably that is the conclusion.

CJEU (Case C-378/15): *Mercedes Benz Italia SpA v Agenzia delle Entrate Direzione Provinciale Roma 3*

5.4 Cars

5.4.1 Available for private use

A sole trader appealed against a decision to disallow input tax on the purchase of an electric car. He had kept it at the office for most of the time since it was purchased, but during the Christmas holiday had stored it somewhere else because of the lack of a secure parking area at the office. Although this "somewhere else" was not his home, HMRC appear to have picked up on this as indicative of private use and issued a decision.

The Tribunal noted that the director intended to use the car purely for business, and appeared to be a straightforward witness acting in good faith. However, there was no evidence that physical or legal constraints had been put in place to prevent private use, so it was inevitably "available". In accordance with precedent, the input tax was not allowed. The appeal was dismissed.

First-Tier Tribunal (TC05415): *Ireland Generator And Spare*

5.4.2 Article

In an article in *Taxation*, Neil Warren considers the three Tribunal decisions on the deduction of input tax on cars that were covered in the last update, and draws conclusions about the requirements that must be met for input tax to be deductible.

Taxation, 27 October 2016

5.5 Business entertainment

Nothing to report.

5.6 Non-business use of supplies

5.6.1 Hot tub

A sole trader operated as a haulier and plant hirer. He occupied (rent-free) and traded from some land owned by his parents, adjacent to their home. He owned one lorry with a crane and an excavator. The appellant did some of the driving. He also employed his step-brother on a part-time basis as a driver. His mother helped with the books, and represented him at the Tribunal.

HMRC had carried out a compliance visit in February 2015 and found among the business records an invoice for a hot-tub and Jacuzzi on which the trader had claimed £1,500 input tax. The Tribunal commented that HMRC did not provide the trader with a copy of their notes from the visit until after a first hearing, where HMRC were directed to produce it, because there was a dispute about what had been said. The appellant was invited to provide their own record if they disagreed with HMRC, but instead the appellant simply commented on HMRC's record. The Tribunal decided that no further hearing of the appeal was required.

In correspondence during 2015, the appellant had claimed that the deduction had been made in accordance with "VAT Notice 700/7: Business Promotions – the use of gifts and rewards given to self-employed persons". HMRC rejected this, and raised an assessment. The trader asked for a review.

The trader maintained the argument that the hot tub was used to help with a shoulder injury (mentioned at the visit) but also that it was a "business gift" used by "employees of the business" (the appellant's step-brother). The case proceeded to a hearing, at which HMRC cited a number of precedent cases that had not been referred to in HMRC's statement of case or notified in advance to the appellant or to the Tribunal, nor were

copies made available at the hearing. The Tribunal therefore adjourned the hearing and made directions to allow the appellant time to read and comment on the cases and to consider whether any other cases should be referred to in support of the appeal.

These cases were *Rosner* (1994) in which the High Court judge said "There must be a real connection, a nexus, between the expenditure and the business. It seems to me that the nexus, if it not to be benefit, must be directly referable to the purpose of the business." The second was *Becker* (Case C-104/12) in which the CJEU emphasised that there must be a "direct and immediate link with the taxable person's economic activity" either in the form of a link to particular output transactions or to the activity as a whole.

The evidence did not support the contention that the principal reason for buying the hot tub was the appellant's shoulder injury. A further argument that the hot tub had been bought in lieu of rent to the parents was also rejected, as there was no contemporaneous evidence of such an agreement. The parents had contributed 20% of the purchase price to the appellant, but no adjustment had been made to the claim, nor any paperwork raised.

The Tribunal concluded that the parents had wanted to help out their son with his business and therefore provided the land rent-free, and the mother helped with paperwork without specific remuneration. She was not an employee of the business and she was not self-employed. There was no evidence of any expectation on her part that she would in due course be able to "cash in" her accrued time helping the business and be paid in the form of this significant purchase.

The business did not fall within any of the categories mentioned in Notice 700/7, which in any case deals with a completely different kind of gift – items of modest financial value. The Tribunal commented: "In our view, the appellant's various attempts, over the course of time, to rely on different parts of the guidance in VAT Notice 700/7 were ingenious and ambitious attempts to fit the purchase of the Hot Tub within the guidance. But those attempts were artificial and they do not succeed." The appeal was dismissed.

First-Tier Tribunal (TC05384): *Ian Kerry Lambert t/a IKL Transport*

5.7 Bad debt relief

5.7.1 Directly enforceable rights

The Court of Appeal has given judgment in the long-running GMAC bad debts case. GMAC's claim was made in February 2006, and the CA judgment was issued in October 2016.

Background

In early 2011, the Upper Tribunal heard an appeal and application by HMRC to have questions referred to the CJEU on the compatibility of the UK law on bad debt relief with EU law before 1997. The UT declined to make a reference, and in 2012 it issued a decision in the substantive hearing. An example of GMAC's argument was given as follows:

a. a customer agrees to pay £15,000 (plus interest) over the period of an hp agreement;

b. the customer stops paying when £10,000 is outstanding (having paid only £5,000);

c. the car is repossessed and sold at auction for £6,500 [this sale being "de-supplied" by the Cars Order 1992];

d. under the terms of the hp agreement the £6,500 is set against the outstanding £10,000 and the customer owes £3,500;

e. the customer then does not pay the £3,500.

4. At the time of the repossession, GMAC would already have accounted for VAT on the full (VAT-inclusive) purchase price of £15,000. It is entitled to adjust its accounts in respect of the reduction in the consideration, that is to say the amount at which the car is resold at auction, pursuant to Regulation 38 of the Value Added Tax Regulations 1995 ("the VAT Regulations 1995"). That adjustment does not, however, cover the amount remaining outstanding, and unpaid, by the customer, that is to say the £3,500. The appeal concerns whether GMAC is entitled to some form of VAT bad debt relief in respect of the £3,500 it does not receive.

GMAC claimed over £2m for the period from 1978 to 1997, arguing that the requirements for the customer to be insolvent (up to 1990) and property in the goods to have transferred (up to 1997) were incompatible with EU law, and also the imposition of a time limit for claims in 1997 was unlawful because it did not provide for a transitional period.

In a preliminary hearing, the UT judge identified three separate issues – the "compatibility" issue and "time limit" issues described above, and also a "windfall" issue, under which HMRC alleged that the company would receive an unjustified benefit if its claim was granted. This was summarised "at a high level" by the judge as reliance on both the EU law (to justify the bad debt claim) and the Cars Order (to de-supply the onward sale of a repossessed vehicle) to produce a result that was neither provided for nor envisaged by either the EU law or the UK law.

The Upper Tribunal agreed with the First Tier Tribunal that the requirement for the customer to be insolvent was not a proportional response to the intended result of fiscal harmonisation. It was not even clear what the purpose of the property condition had been, and it did not affect the fact that a bad debt had arisen. The Directive gave the trader directly effective rights which had been denied, so the claim was valid in principle.

The UT also agreed with the First Tier that the transitional period from November 1996 to March 1997 had not been adequate, so the previous time limit should be treated as if it had never been repealed. The claims were therefore still in time. There was no need to refer a question about this to the CJEU, because the court would say that it was for the national courts to decide what was proportional. As the Upper Tribunal did not consider it to be so, that ended the matter.

However, the UT was not sure whether HMRC's "windfall" argument might have some validity in EU law. The interaction of bad debt relief, a claim to reduce consideration received, and the ability to reduce the

consideration on the sale of repossessed vehicles led to an over-favourable result that could not be in accordance with the intention of the Directive. This could not be resolved without a reference to the CJEU.

The CJEU gave judgment in favour of GMAC (Case C-589/12) in the third quarter of 2014. The "windfall" argument could not be used by a Member State to disapply the direct effect of art.11C(1) 6th Directive. It was characterised as "*arguing that that person could rely on the provisions of national law in relation to another transaction concerning the same goods and that the cumulative application of those provisions would produce an overall fiscal result which neither national law nor the Sixth Directive, applied separately to those transactions, produced or was intended to produce*." It appeared therefore that GMAC was able to rely separately on national law for one transaction and direct effect of the Directive for the other, and enjoy a fiscal windfall.

Court of Appeal

HMRC appealed to the Court of Appeal, where the judges considered again whether the property condition and insolvency condition could be justified. HMRC maintained that the UK had a right to a partial derogation in respect of adjustments for non-payment, and the court examined the law, various precedent cases and the arguments in detail. Floyd LJ accepted that the Member State could derogate entirely from making bad debt adjustments, but a partial derogation had to be proportionate and could not escape scrutiny.

The property condition excluded not only hire purchase contracts but also any sale subject to retention of title from making a bad debt claim. The court considered that such a blanket exclusion was neither appropriate nor necessary.

Similarly, the insolvency condition imposed excessive difficulty on claiming relief: in the great majority of GMAC's cases, the customer was an individual, and it would not be commercially sensible to pursue insolvency proceedings. Accordingly, both of these conditions should be disapplied, and the bad debt claims were in principle valid.

Turning to the time limits, the court held that the imposition of the time limit on bad debt claims in s.39(5) FA 1997 did effectively bar GMAC's claims for bad debt relief for supplies made before 1 April 1989, at least as far as domestic law was concerned. The decision is technical, but in summary the judge considered that a Member State has some discretion to regulate its bad debt provisions, and the time limit imposed by s.39(5) was within the scope of that discretion. The abolition of what was called the "old scheme" of bad debt relief (for supplies before 1 April 1989, when there was no time limit for claiming) did not render it excessively difficult or practically impossible for GMAC to make claims, because they could have done so at any time up to the enactment of the FA 1997.

By contrast, the judge dismissed HMRC's argument that GMAC's EU-law based claim had lapsed because of a failure to exercise it within a reasonable time. Claims were made within the domestic framework, and the application of an EU-based "reasonable time" principle was neither required nor appropriate.

The decision is not clear about the interaction of these two points, but it appears that the second of these two decisions allows claims on supplies

from 1 April 1989 onwards. The court allowed GMAC's appeals on the insolvency and property issues and on the "reasonable time" point, and allowed HMRC's appeal on the time-bar imposed by s.39(5) for supplies before 1 April 1989.

Court of Appeal: *HMRC v GMAC (UK) plc*

5.8 Other input tax problems

5.8.1 *Kittel* principle

A company was denied input tax of £32,090 for its 11/12 period, and a penalty of £12,354 (38% on the deliberate scale) was levied for the same matter. The company had claimed the input tax on 12 invoices from a connected company, which was separately VAT-registered, in relation to management and construction services supplied between 21 May 2008 and 20 November 2012. All the invoices were dated 30 November 2012.

The two companies were involved with the financing and development of a mixed residential and commercial development. They were badly affected by the financial crisis of 2008 and following, and were very late filing a number of VAT returns. HMRC began an investigation into VAT, Construction Industry Scheme and PAYE compliance. The connected company raised the invoices but was unable to account for the output tax, and went into liquidation shortly afterwards owing HMRC considerable amounts of money. The officer investigating the input tax claim appears only to have become aware of the liquidation of the supplier late in the proceedings (even though it was HMRC petitioning for the winding-up), and initially the input tax was disallowed for lack of evidence of supplies. Later this was changed to "Kittel" grounds, that the director knew or ought to have known that the transactions were connected with fraud.

The Tribunal noted that clearly the director would have known that the transactions would have been connected to a VAT loss, because he was the director of both companies and was aware of the insolvency. The question was whether this was fraudulent. The Tribunal considered the question of when knowledge of fraud was to be tested, and reviewed the state of the director's mind at three different stages:

- over the four years during which services were provided and no VAT was accounted for – there was no plan to defraud HMRC, because although the supplier did not account for output tax, nor did the customer claim input tax;
- when the invoices were raised – there was no plan to defraud HMRC, because the director still believed that the company could be saved and all debts paid;
- when the VAT return was submitted – by now the director should have known that the supplier would not pay the output tax. Although the Tribunal clearly had sympathy with a man who had suffered business difficulties and had worked very hard to try to resolve them, it concluded that he had been driven to actions that were by the standards of VAT precedent dishonest.

The appeal against the assessment and the penalties was dismissed.

First-Tier Tribunal (TC05416): *Victoria Walk Ltd*

5.8.2 Admissibility of evidence

A company was denied input tax in relation to purchases of mobile phones and denied zero rating on the sale of mobile phones. HMRC alleged that the invoices purporting to support the purchase did not comply with reg.14, because they did not adequately describe the goods: they had evidence that there were not enough of these phones available on the market at that time to fulfil these transactions, so the invoices could not be accurate. If they could prove that on the balance of probabilities, it would not be necessary to allege fraud, knowledge or means of knowledge. HMRC also alleged that the transport documents supporting the supposed despatches to other member states were unreliable, partly because they were issued by a company that was involved in a number of other frauds. Once again, they argued that they did not need to show bad faith by the company, only that the documentation did not satisfy the statutory requirements.

A dispute followed about the admissibility of some of HMRC's evidence, in particular witness statements from two officers. The company claimed that these witness statements implied that the company was involved in a fraud; if HMRC wished to allege that, it should plead it fully with evidence, and if it did not wish to do so, it should not make prejudicial statements of this kind. The First-Tier and Upper Tribunals agreed that the witness statements should be struck out, at least to the extent that they referred to fraud.

The Court of Appeal agreed with the Tribunals in relation to the input tax side, where the witness statement did no more than refer to criminal convictions of certain employees of counterparties. The judge could not see its relevance to a dispute about the invoices. However, he considered that the statement about the despatches (with some passages excised) was relevant to the reliability of the documentation, and should therefore be considered by the Tribunal.

He described his judgment as "taking the short route": rather than considering very detailed arguments of the two counsel about the rightness or wrongness of the principles of the Upper Tribunal judge's conclusion, he considered that it would be appropriate for the case to proceed to a full hearing where the evidence could be tested. Underhill LJ and Arden LJ agreed.

Court of Appeal: *HMRC v Infinity Distribution Ltd (In Administration)*

5.8.3 Allegations of dishonesty

In TC04075, the FTT considered HMRC's denial of input tax for periods 05/06 and 06/06 – £1.326m in relation to 16 purchases of mobile phones. It was agreed that all the deal chains led to missing traders, and that the onus lay on HMRC to prove knowledge or means of knowledge.

The company had been in existence since 1987 and had been engaged in import and export of other goods. Other features that set it apart from other fraudulent traders were the absence of a First Curacao International

Bank account, and variations in the margins it made on its transactions. It had obtained inspection reports on all the deals and paid for insurance.

The Tribunal decided that the director was "an intelligent and sophisticated businessman" who could provide no logical explanation of the commercial rationale behind the deals. This was convincing evidence that there was none; the decision went through a long list of reasons for concluding that the director actually knew of the connection between deals 2 to 16 and fraud, and that he ought to have known of such a connection in relation to deal 1.

The company appealed to the Upper Tribunal on eight grounds, of which the UT agreed it could present seven. The first three were related, and were in common with a number of other arguments on MTIC cases: that HMRC had suggested and implied dishonesty on the part of the director without explicitly alleging fraud. The argument is that a suggestion of fraud should be openly pleaded in order to give the appellant a proper chance to defend himself. The Tribunal considered this in detail in relation to the present case, and concluded that the allegation of fraud was central to HMRC's case. This was not the same as the cases of *E Buyer* and *Citibank*, which were case management disputes in which allegations of fraud needed to be properly particularised; this was a substantive hearing where all the arguments and evidence had been presented and weighed. There was no indication of an error in the FTT's conclusion.

The other grounds of appeal were considered in turn and dismissed. The company's appeal was dismissed again.

Upper Tribunal: *Prizeflex Ltd v HMRC*

5.8.4 Standard MTIC

A company was denied input tax of £346,670 claimed for its 05/06 accounting period. The director had previously worked in the industry: this was not one of those businesses that suddenly started to deal in mobile phones from no base or from a different base. However, the director gave evasive or untrue answers to some of the questions in the Tribunal, and the Tribunal was satisfied that he knew at the time that his transactions were connected with fraud. If that was wrong, he surely had the means of knowing, as the business was not running on normal commercial principles.

First-Tier Tribunal (TC05529): *Expeditors Ltd*

A company appealed against a refusal of input tax of £7.79m in the four monthly periods from 04/06 to 07/06. This was a case in which the appellant sought to put HMRC to proof on every aspect of their case in respect of 51 deal chains, and then argued that HMRC had suppressed evidence and acted abusively. The hearing lasted for 11 days in March and April 2015 and another 3 days in November and December of that year.

The Tribunal examined the facts and arguments over more than 540 paragraphs and came to the usual conclusions: the judge said that the evidence of actual knowledge of fraud was particularly compelling, and the "means of knowledge" *Kittel* test was also satisfied.

First-Tier Tribunal (TC05443): *ATEC Associates Ltd*

5.8.5 Invalid invoices

A company appealed against a decision to disallow £80,500 of input tax relating to 32 invoices spanning 8 return periods from 05/11 to 02/13. By the hearing, the company had accepted the disallowance of 6 transactions for which it could not produce an invoice, amounting to £15,112. The remainder were still in dispute. For 13 of these HMRC contended that there had been no supply; for the other 13, HMRC contended that the supplier was a "missing trader". The transactions related to supplies of workers on construction jobs.

The Tribunal examined the 13 invoices and found various faults with them. Some of them were "self-billing" invoices produced by the company itself. Several did not contain VAT numbers, and others did not adequately describe their subject matter. All were held not to be valid invoices for the purposes of reg.14.

However, there was alternative evidence in the form of payment records that showed that the company had paid suppliers in relation to these invoices. This evidence had not been considered adequately, if at all, by the reviewing officer. The Tribunal concluded that this rendered HMRC's decision to refuse deduction "unreasonable"; the appeal was allowed, but only to the extent that the deductions in relation to 20 invoices should be reconsidered by a different HMRC officer and a fresh decision taken on the basis of the alternative evidence.

First-Tier Tribunal (TC05394): *GMK Building Contracts Ltd*

A sole trader claimed input tax deduction on various works carried out to his warehouse. HMRC ruled that the invoices did not comply with reg.14 and refused to accept other evidence as sufficient to justify the deduction. They imposed a "careless behaviour" penalty as well.

The FTT agreed with HMRC that the descriptions in the invoices were too vague to comply with the regulation. That meant that HMRC were correct to disallow the VAT and consider alternative evidence. There was insufficient evidence of the actual supplies – no record of negotiations, estimates, quotes; incomplete evidence of cash payments or loans from friends and family that the trader claimed to have used to finance the works. HMRC's decision not to exercise discretion in his favour was not unreasonable.

The FTT also found that a reasonable trader intending to comply with his tax obligations would have obtained and retained sufficient records to demonstrate what work had been done, who had done it and how much they had been paid. The Tribunal suggested "if a trader is not capable of keeping his own records, he should arrange for somebody else to do so."

First-Tier Tribunal (TC05376): *Gurcharan Singh*

5.8.6 Pre-registration VAT

Following a debate that has gone on for some two years, HMRC have formally clarified that they have not changed their policy in relation to claims for input tax on fixed assets held at the date of registration: some officers have been requiring the reg.111 claim to take into account depreciation or use for making non-taxable pre-registration supplies, but

HMRC now accept that their policy has always been to allow a fully taxable business to recover the whole amount incurred on purchase.

The Brief emphasises that the policy is that, subject to the normal rules on VAT deduction:

- VAT on services received within 6 months of EDR and used in the business at EDR is recoverable in full;
- VAT on stock is deductible to the extent that the goods are still on hand at EDR (for example apportionment may be required);
- VAT on fixed assets purchased within 4 years of EDR is recoverable in full, providing the assets are still in use by the business at EDR.

Full recovery only applies if the business is fully taxable. If the trader is partly exempt, has non-business activities, or needs to restrict VAT deduction for any other reason, it is necessary to take that into account when calculating the deductible VAT.

The Brief notes that the rules are different for capital items, for which the treatment is set out in Notice 706/2.

HMRC will accept corrections for overpayment of VAT in the following circumstances:

- the business has reduced the VAT it deducted on fixed assets, to account for pre-EDR use;
- HMRC raised an assessment of tax to account for pre-EDR use of fixed assets;
- HMRC reduced a repayment claim to account for pre-EDR use of fixed assets.

HMRC will also consider claims for repayment of penalties and interest charged as a result of assessments.

The time limits for error correction are:

- 4 years from the due date of the relevant VAT return where VAT deduction has been restricted in error by the business, or HMRC incorrectly reduced a repayment;
- 4 years from the date the assessment was paid where HMRC raised an assessment that incorrectly restricted VAT deduction.

Guidance in the VAT Input Tax manual and Section 10 of Notice 700 will be amended to ensure the policy position is clear.

Revenue & Customs Brief 16/2016

5.8.7 S.33 bodies

The Value Added Tax (Refund of Tax to the Tees Valley and West Midlands Combined Authorities) Order 2016 specifies the Tees Valley Combined Authority and the West Midlands Combined Authority as government bodies entitled to recover input tax under VATA 1994, s 33 on non-business supplies, with effect from 7 November 2016. A Tax Impact and Information Note has also been published about the change.

SI 2016/993; *http://tinyurl.com/zhtqb2w*

6. ADMINISTRATION AND PENALTIES

6.1 Group registration

6.1.1 Management buy-out

A fully taxable company's directors decided to carry out a management-led buyout. A new holding company was incorporated on 28 March 2011 as a vehicle for the buyout, and all staff were given the opportunity to invest. The transaction was completed on 28 April 2011; a group registration was issued on 19 April 2011 with effect from 1 April 2011, with the trading company as the representative member. Input tax on legal and accountancy fees relating to the buyout was claimed on the group's 06/2011 VAT return. HMRC carried out a visit in 2014 and ruled that the VAT did not relate to taxable supplies, so it should not have been claimed. The company appealed.

HMRC's main basis for the ruling was the *BAA* case, which superficially seems very similar: costs relating to a takeover were claimed on the group's VAT return after the takeover had been completed, and the new holding company had never been registered for VAT in its own right. It is worth considering HMRC's submissions in full, as summarised by the Tribunal judge:

(1) Joining a VAT group does not allow costs that would otherwise be irrecoverable under a single registration to be recoverable as part of the group. In a management buyout situation the direction and purpose of the supplies must be looked at, not just who paid the invoice and to whom it was addressed;

(2) The supplies in question were fully consumed within the management buyout process and could not relate to any taxable supplies to be made by the VAT group;

(3) Where a holding company acquires a subsidiary in order to receive a dividend, this is regarded as an investment activity rather than an economic activity and any VAT incurred is non-deductible;

(4) For input tax to be deductible there must be a direct and immediate link between the costs incurred and the taxable supplies and joining a VAT group does not create such a link unless one can be traced through intra-group supplies;

(5) Although general costs have a direct and immediate link to all of a business' supplies because they are cost components of the business as a whole, HMRC does not consider that management buyout costs are general costs.

There were several different grounds of appeal, all of them interesting lines of argument. The first was that the engagement letters were issued between the appellant and its advisers in February 2011 before the new holding company was incorporated, so on *Redrow* principles the supplies were made to the appellant rather than to the holding company. The second was that the invoices were issued after the group registration had taken effect, so at the time of supply the services were received by the new deemed single entity. Most importantly, the company argued that the purpose of the management buyout was business-related – it was to

promote growth and efficiency in the business by rewarding, incentivising and motivating the management and employees. The costs were therefore overheads of the business, rather than relating to something outside the business.

The company argued that the absence of intra-group management charges was irrelevant, because the supplies had been made to a single entity. HMRC's insistence that there should be such charges seems to be consistent with their policy statement in late 2014.

The decision is relatively brief for something that contained so many lines of argument on both sides. The judge (Rachel Mainwaring-Taylor) considered that the motivation of the staff was the underlying reason for the buyout, and that was business-related in a way that the third party takeover in *BAA* was not. The VAT was incurred either by the group or by the appellant as an individual company, in either case by a taxable person acting as such; it related to the business as a whole. The appeal was allowed.

First-Tier Tribunal (TC05480): *Heating Plumbing Supplies Ltd*

6.1.2 Consultation

As announced at Autumn Statement 2016 a consultation on the treatment of VAT groups will run from 5 December 2016 to 27 February 2017. The purpose of the consultation is to inform UK policy following the significant decisions of the CJEU in *Larentia + Minerva and Marenave* (Cases C-108/14 and C-109/14) and *Skandia America Corporation* (Case C-7/13). HMRC's summary of Finance Bill 2017 measures states "The cases were about eligibility for VAT grouping and the treatment of cross-border transactions", which covers *Skandia* but possibly suggests that HMRC have still not quite understood *Larentia*. The consultation will invite UK business views on whether and, if so, what UK legal changes are required following these cases and the international response.

www.gov.uk/government/publications/finance-bill-2017-draft-legislation-overview-documents

6.2 Other registration rules

6.2.1 Business splitting?

An individual carried on three separate activities, acting as a professional decorator, carpenter and project manager. HMRC considered that he should be registered for VAT because his turnover had exceeded the limit; he responded with an argument that the project management business was carried on in partnership with his wife, and the turnover should therefore be treated separately.

HMRC had picked the trader up in April 2011 on the basis of self-assessment returns. They required production of monthly turnover figures for 2008/09 and examined the self-assessment returns for 2006/07 and 2007/08, and concluded that the threshold had been exceeded in April 2008. A notice of compulsory registration was issued with effect from 1 June 2008, together with a penalty of £10,750 for belated notification. This was reduced to £3,247 after actual turnover figures were supplied,

representing mitigation of 25% of a revised figure of VAT. The s.67 penalty calculation was 15% of the VAT from 1 June 2008 and 15 May 2011 when they became aware of the liability to register, and the penalty levied was 75% of that.

By the time of the appeal hearing in September 2016 the trader still had not submitted any VAT returns. That meant that he could not appeal against the liability to VAT, but he could appeal against the decision to register and against the penalty.

The Tribunal recorded the history of the business. The trader was described as good with his hands but not good with paperwork. He had relied on visits to HMRC's local enquiry office in Ealing and later Kingston for help with his tax returns. He called two HMRC officers as witnesses to the fact that he had visited and asked questions; although only one of them could remember him, HMRC's records showed that he had made regular contact over several years. He asserted that he had discussed VAT registration with the HMRC officer in Kingston on more than one occasion, and she had told him that as long as the three businesses were separate, there was no need to register. She did not consider this likely, and her meeting notes did not refer to VAT; she had no recollection of the individual taxpayer, but the meeting notes were read over with him and she thought he would have corrected them if they had made such an important omission.

The trader's wife had a Polish university degree. She helped with the project management until their child demanded too much of her time. He now employed a Polish PA to help do what his wife had previously done. The Tribunal accepted that she genuinely worked in the business and probably was very significant to it, but did not accept that the appellant had been in partnership with her. There were several reasons for this:

- the appellant said that his wife did what the PA now did instead;
- the project management was an extension of the carpentry and decorating;
- the wife's role was mainly to do with paperwork rather than actual management;
- there was no other evidence of a partnership beyond the witness statements, and no record in the meeting notes of a partnership being mentioned;
- she did not file tax returns on the basis that she was earning a profit share.

The trader relied on the case of *George Christodoulou*, in which the FTT held that a restaurant was being run in partnership with the appellant's wife and could therefore be kept separate from a hairdressing salon in respect of which he was a sole trader. There had been some evidence in that case that activities were carried on jointly, even though the trader had not initially told HMRC of his wife's involvement; in particular, the restaurant and liquor licences were held in joint names.

The Tribunal concluded that there was no basis on which to overturn the registration decision. The trader also did not have a reasonable excuse for failing to register in 2008, even if he had misunderstood advice given to

him by an officer in 2010. However, the Tribunal decided for a number of reasons to mitigate the penalty by 100%. The trader had mental health problems that he had disclosed to HMRC, giving them a duty of care to help him with his tax affairs; he had clearly always tried to keep his tax affairs in order by regularly discussing them with HMRC. His belief that discussing SA tax with HMRC addressed all his tax issues was not an objectively reasonable one, but it was a mitigating factor. HMRC had also made a serious mistake in attempting to collect the penalty, causing significant distress to the family, when an appeal letter had been ignored or mislaid.

First-Tier Tribunal (TC05392): *Dean Jason Butler*

6.2.2 Late registration

A partnership of roofing and cladding contractors appealed against penalties for belated notification imposed by HMRC for several periods on a "liable no longer liable" basis. They did not dispute that they had failed to register at the right time, but asked for leniency on the basis that they had been misled by professional advisers.

They had initially worked as separate individuals, but had been required by a client to invoice as a single self-employed unit so they could be approved under the Construction Industry Scheme. They still believed that they were below the registration threshold because they thought they were entitled to exclude from turnover goods purchased on behalf of clients. Their accountant pointed out that they had submitted returns to HMRC for seven years before HMRC had raised a problem.

The judge noted that the firm could not appeal against the assessments because no VAT returns had been submitted for the periods in question. He was satisfied that HMRC's decisions with regard to registration liability were correct. Although the traders had been poorly advised, they did not have a reasonable excuse that would cover the whole of the period for which they had failed to register. They should have followed up enquiries that they themselves had made when they were not satisfied with the advice given to them by their previous accountant. The appeals were dismissed.

First-Tier Tribunal (TC05461): *I & S Ward Roofing and Cladding*

A trader took over a takeaway food outlet in October 2003. His accounts for the next 11 years consistently showed turnover below the VAT registration threshold. However, an enquiry led HMRC to conclude that some turnover was being omitted from the records. The Tribunal had very little evidence to work with, but concluded that HMRC could not reasonably extrapolate the suppression percentage from invigilations in 2014 all the way back to 2004 – circumstances had changed, including taking on "Just Eat" delivery business. On a pure extrapolation from the 2003 turnover to the present day, the business would have crossed the threshold in late 2007. The Tribunal decided that it was more likely than not that the business should be registered not later than 1 January 2009, and that was the basis of the decision.

The following comment is interesting:

21. We were not hearing appeals against assessments. We were told that no assessments had been raised. If and when they are then the appellant

has, as far as we can see, full rights of appeal and may argue that turnover was not in fact above the threshold, though the appellant would of course have to produce convincing evidence of that fact to any Tribunal. It may also of course dispute the amounts of any assessments even if it accepts that the turnover was above the threshold.

22. We add here, because it disturbed us somewhat, that Mr Haley had submitted that any assessments that might be raised could not be appealed until the relevant returns had been filed. We asked him for his authority for this statement and he told us it was s 84(2) VATA. We see however that that subsection, which did indeed have the effect that Mr Haley said it had, was repealed by paragraph 221 of Schedule 1 to the Transfer of Tribunal Functions and Revenue and Customs Appeals Order (SI 2009/56) with effect from 1 April 2009. We hope that this Tribunal has heard the last of this suggestion.

First-Tier Tribunal (TC05475): *Omid Khazaei*

6.2.3 Voluntary registration enforced...

A cafe and restaurant registered voluntarily on 25 November 2011, shortly after incorporation. The company failed to file a series of VAT returns and was subject to assessments and surcharges. In August 2014 it changed advisers, and its new accountants wrote to apply for deregistration with immediate effect on the basis that its supplies were, and always had been, below the registration threshold.

A year later, the accountants wrote again, applying for cancellation of the registration altogether. The company's director claimed to have been seriously misled by his previous advisers, who had allegedly told him that he was required to register for VAT but that he would not have to account for any VAT until his turnover crossed the threshold. The Tribunal considered that it was likely that this was what he had been told, as it was consistent with various records of the director's conversations with HMRC going back to the beginning.

The director argued that the circumstances in VATA 1994 Sch.1 para.13(3) provided for cancellation of registration from the outset if there has been a serious error, and that this covered his situation. The judge agreed with HMRC that the provision referred to errors in identifying the trader or in determining that it was eligible for registration. Where a trader was either required or entitled to be registered, and it had registered, it was a "taxable person"; deregistration could only take effect from the date that the application was received. HMRC had no power to backdate it, nor did the Tribunal.

The judge noted also that there was no "reasonable excuse" provision in this area. The trader, who had come to the UK from Canada and opened the restaurant as his first business venture, had understandably and reasonably taken professional advice and appeared to have been seriously let down. However, the Tribunal was bound by the legislation and could give him no remedy.

First-Tier Tribunal (TC05537): *Inspired By Service Ltd*

6.2.4 ...and again

A similar point arose in an unusual situation. An Irish company was registered in the UK from 1993 under the distance selling regulations. It supplied audio cassettes with foreign language teaching materials. In 2012 it asked HMRC for clarification of the liability of its supplies, and discovered that HMRC regarded them as zero-rated – the cassettes and CDs were incidental to the supply of a magazine. HMRC refunded four years' worth of output tax (£56,294) on an error notification, but refused to cancel the registration from 1993 or to refund tax going any further back.

This was a registration under Sch.2 rather than Sch.1, and the rules are slightly different. There is no equivalent in Sch.2 to Sch.1 para.14 (exemption from registration if all supplies are zero-rated). The Tribunal considered a number of arguments put forward by the director, but could find no basis for overturning HMRC's decision to refuse to backdate the cancellation of the registration. Indeed, the judge commented that even if that had succeeded, it was not clear how any further VAT would have become repayable – the repayment cap in s.80 VATA 1994 would still have applied to restrict the possibility of any further refund of output tax.

The appeal was dismissed.

First-Tier Tribunal (TC05551): *Authentik Language Learning Resources Ltd (in liquidation)*

6.2.5 Updated Notice

HMRC have updated their Notice *Should I be registered for VAT?* to reflect their new powers to make online marketplaces jointly and severally liable for an overseas seller's VAT, and to direct that certain non-established taxable persons should appoint a VAT representative.

Notice 700/1

6.2.6 Article

In an article in *Taxation*, Neil Warren offers some "Festive Cheer" – planning suggestions that save money. These include:

- voluntary registration for those who deal with registered customers, including backdating and recovery of past input tax;
- use of the flat rate scheme, again particularly for those who deal with registered customers;
- recovery of pre-registration input tax;
- the annual accounting scheme;
- resisting any assertion by an officer that an error was "deliberate" and deserving of the higher penalty scales, when in practice many taxpayers are merely careless.

Taxation, 15 December 2016

6.3 Payments and returns

6.3.1 Aggressive abuse of the VAT flat-rate scheme

The Autumn Statement included an announcement of a new flat rate for "limited cost traders" (LCT) to apply from 1 April 2017. A limited cost trader is one whose VAT-inclusive expenditure on goods is less than 2% of the VAT-inclusive turnover for the period, or if greater than 2%, is less than £1,000 per year (reduced proportionately for a return period of less than a year). Expenditure on goods only partly used for the business, capital goods, food for consumption by the business or its employees, and vehicles and fuel (except for a transport business) does not qualify.

The LCT flat rate will be 16.5%, which means that a trader with £120,000 of gross turnover (all standard rated) will only pay £200 less in flat rate VAT than the full standard rated output tax. Clearly if any of the turnover is zero rated or exempt, the LCT rate will be disadvantageous.

Apparently this is aimed at a business-splitting scheme highlighted by an investigation by the Guardian newspaper: an employment agency supplying 1,000 temporary workers to a warehouse can split into 500 companies with two employees each in order to claim NIC Employment Allowance (worth £3,000pa in reduced employer's NIC), and can also then use the FRS to keep some of the output tax that the customer can recover in full.

HMRC appear to have a number of possible ways of blocking this type of scheme already, but have chosen instead to create a new flat rate that will also affect many other businesses currently using it. Many service businesses will fall into the definition of LCT because the only qualifying goods that they are likely to buy would be stationery. Those currently using the 12% rate will be much worse off; even those currently on the high 14% or 14.5% rates will see the limited financial incentive to use the FRS disappear. For such businesses, it will make financial sense to go back to the "normal rules of VAT", ending the simplification benefit that they (and HMRC, in the reduced need for compliance checking) have enjoyed since 2002.

Note that the test of being a LCT will have to be carried out period by period: it will be possible to be a LCT in some periods but not others, e.g. by buying a year's worth of stationery all at once (and using quarterly rather than annual accounting). However, a business that is LCT for 9 months and "normal FRS" for 3 months will probably still be better off under the normal rules of VAT.

www.gov.uk/government/publications/tackling-aggressive-abuse-of-the-vat-flat-rate-scheme-technical-note

HMRC's Notice VAT flat-rate scheme for small businesses has been updated to describe anti-forestalling measures that will prevent LCTs from using the "old" flat rate for supplies made after 1 April 2017 by receiving prepayments. These measures have been included in the Notice on 23 November 2016, even though they are officially subject to consultation, and the draft legislation was only published on 5 December.

Notice 733

HMRC have published a Tax Impact and Information Note: *Tackling aggressive abuse of the VAT flat rate scheme*. It does not give any further details of the "abuse", but simply comments that businesses with limited costs enjoy a significant benefit under the FRS. This announces the creation of an online tool to help traders determine whether they are required to use the new rate, which has apparently cost HMRC £415,000 in capital costs to develop. The statistics published in the TIIN are very limited, but interesting: HMRC expect 4,000 businesses to switch from the FRS to standard VAT accounting: this will increase their compliance costs by £180 per business (but they will, of course, also lose their FRS benefit).

They believe that businesses trading below the registration threshold may decide to deregister, in which case they will also lose any FRS benefit, but their administrative burdens may reduce by £390 on average.

They also believe that there are 24,000 FRS businesses whose costs are close to the test threshold, who do not employ an accountant and do not wish to de-register, and for these businesses there will be a small administrative burden in checking whether the test applies, costing some £65 per business.

www.hmrc.gov.uk

In an article in *Taxation*, Mike Thexton discusses the reasons for the proposed change, the likely consequences, and possible alternatives available to HMRC for preventing the abuse.

Taxation, 8 December 2016

6.3.2 Long-standing misunderstanding

An individual carried on a sole trade as a courier. He was registered for VAT with effect from 6 May 2003 and was authorised to use the FRS from 1 August 2004. In 2007 HMRC asked him to check his records and confirm he was using the FRS correctly, which he did; a return in 2009 was sent back to him for correction of an error. HMRC then notified a visit scheduled for 13 November 2015. It transpired that he had been calculating the FRS VAT as a percentage of the VAT he had charged rather than as a percentage of the gross VAT-inclusive amount. He was assessed for £10,660 covering the quarters from 01/12 to 07/15.

The trader appealed. HMRC claimed that his grounds of appeal disclosed no arguable point of law: he stated that he had had a conversation with an officer on the telephone after making a mistake in one of his first returns and had been told to "carry on doing what you're doing". He was upset that an error of this kind had never been picked up. The Tribunal accepted that this was the appellant's true belief as to the events that occurred.

The Tribunal expressed sympathy with the appellant's predicament, but agreed with HMRC that an argument based on misdirection or any unfairness in HMRC's conduct did not fall within the jurisdiction of the Tribunal. The trader did acknowledge that he had enjoyed the benefit of his misunderstanding from 2004 to 2011, and HMRC did not seek any penalties.

HMRC's application to strike the appeal out was granted.

First-Tier Tribunal (TC05541): *David Jenkins*

6.3.3 Online filing

Two companies appealed against HMRC's decisions that they did not qualify for exemption from online filing. As is usual in cases on this issue, Judge Mosedale presided at the hearing. The appellants were two companies, one of which had already had an appeal in respect of an earlier ruling dismissed. Judge Mosedale considered among other points whether it would be an abuse of process to allow the company to argue the same point again, even though it had already lost a similar argument; she rejected this ground for striking out, as she concluded that the law was uncertain, and the other company had not been party to the earlier appeal.

She also refused to strike out the appeal on the grounds that companies could not have rights protected by article 9 of the European Convention on Human Rights, but she did consider that the appellant had no reasonable prospect of success in putting forward that article 9 applied to his circumstances. His reasons for not using the internet were personal rather than religious, and not strong enough to prevent him using it where absolutely necessary for the survival of the business: "fundamentally, his belief is a belief that the law is wrong to require persons to file online even if they don't want to do so: but Article 9 is not there to protect beliefs that the law is wrong else no one would be obliged to obey a law with which they disagreed."

Judge Mosedale did not accept that the director's bad back was a "disability" relevant to inability to file online, but refused to strike out the appeal based on "other grounds" – HMRC argued that he was "too young" to use his age (52) as a reason not to file online, but Judge Mosedale considered that the fact that he did not learn to use computers at school or university was at least an arguable point. She issued directions about the future conduct of the appeal, which could proceed on the specific ground that the director's age was enough to make online filing an unreasonable requirement. The directions included a requirement to file an electronic copy of skeleton arguments and witness statements.

First-Tier Tribunal (TC05520): *Glen Lyn Generations Ltd and another*

6.3.4 Interest manual updated

A new section was added to HMRC's VAT default interest manual in October 2016. This confirms that HMRC will continue to charge interest on an assessment issued before a taxpayer joins a VAT group, which will be collected in the name of the taxpayer's former registration.

www.gov.uk/hmrc-internal-manuals/vat-default-interest/updates

6.4 Repayment claims

6.4.1 Group claims

The Upper Tribunal has heard the appeals in two cases about the correct person to make a reclaim where a company was a member of a VAT group and is no longer.

In a case involving BMW (UK) and MG Rover, Rover had been part of BMW's VAT group at the time when output tax was overpaid on some of its transactions. It had left the group and was independently registered by the time the *Fleming* claim window opened, and it claimed the repayment. BMW also claimed. HMRC considered that BMW's claim was correct, but Judge Mosedale held that the legal fiction of the single entity only lasted as long as the companies remained within the VAT group registration. Once the group had split up, the rights to repayment would be reallocated to what she called "the real world supplier" (RWS) – the company on whose transactions the VAT had been overpaid. BMW and HMRC appealed.

In a case involving Standard Chartered and Lloyds Banking Group, a subsidiary had left the SC group and joined the Lloyds group. A similar repayment claim arose; a different FTT judge came to the opposite conclusion, that the representative member at the time of the error had filed the erroneous VAT return, and it was therefore that company that had the right and the responsibility to correct it.

There were in fact two separate periods, during one of which the subsidiary had itself been the representative member of a VAT group, and SC had been its corporate holding company. SC claimed the repayment on the basis that, as the holding company, it had borne the burden of the overpaid tax. The FTT held that the subsidiary was entitled to the repayment for this period, and SC appealed. For the second period, during which SC was the representative member, SC was entitled to the repayment, and Lloyds appealed.

There was a further dispute in the FTT about a company that had been separately registered up to 1996, when it joined the SC VAT group, before later also being sold to Lloyds. The FTT held that only that company was entitled to make a repayment claim for the period while it was separately registered, and SC did not appeal.

The Upper Tribunal summarised the positions of the various appellants as follows – that the right to claim:

(i) lay with the representative member for the time being of the VAT group of which the RWS had been a member at the time of the supply (BMW's view);

(ii) lay with the representative member of that group until the RWS left it, when it reverted to the RWS (MG Rover's and Lloyds' view); and

(iii) lay with the representative member while the VAT group was extant but on the coming to an end of the VAT group devolved on the company which had borne the economic burden of the wrongly charged VAT (SC's view).

Lloyds and MG Rover also submitted that a reference should be made to the Court of Justice.

The Upper Tribunal reviewed the UK law and the EU basis for it. The judge noted that s.80 refers to "a person [who] has accounted for VAT for a prescribed accounting period..." making a claim for repayment. CJEU precedents were examined for their limited guidance: *Ampliscientifica Srl* (Case C-162/07), *Commission v Ireland* (Case C-86/11), *Commission v Sweden* (2013), *Skandia* (Case C-7-13), and *Larentia + Minerva* (Case C-108/14). The Tribunal derived the following principles from these cases:

(1) during the currency of grouping, domestic legislation is required to have the effect that the only taxable person is the single taxable person so that the individual members of the group are not treated as taxable persons. This affects in particular whether or not a supply is made and the quantification of VAT liability;

(2) the purposes of Article 4(4) are administrative simplification and the avoidance of abuse;

(3) member states have a margin of discretion in the implementation of Article 4(4), but must exercise that discretion having regard to the purpose of the Article and in accordance with EU law principles including that of fiscal neutrality (whereas fiscal neutrality is not an object of grouping (if it were one would expect grouping to be mandatory), member states must exercise their discretion with due regard to that principle).

None of the cases dealt directly with the way in which the rights and obligations of the several persons who were treated as the single taxable person should be permitted or required to be allocated among them. However, the Tribunal considered that it was at least consistent with these judgments for the rights and obligations which have arisen during the grouping to continue to be treated as rights and obligations of the members, treated as a single person, after grouping ceases.

The domestic precedents on grouping in general were *Thorn Materials Supply Ltd* (HL 1998), *Barclays Bank* (CA 2001) and *Intelligent Managed Services Ltd* (UT 2015). There was also a decision of the Court of Session on the precise question at issue in this appeal, *Taylor Clark Leisure* (2016).

The Tribunal then considered the "*San Giorgio* line of cases" which have considered the trader's rights to recover taxes levied in breach of EU law (*SpA San Giorgio* Case C-199/82; *Societe Comateb* Cases C-192 to 219/95; *Weber's Wine World* Case C-147/01; *Reemtsma Cigarettenfabriken* Case C-35/05; *Lady & Kid A/S* Case C-398/09; *Danfoss A/S* Case C-94/10; and *Alakor Gabonatermelo es Forgalmazo Kft* Case C-91/12). SC argued that the *San Giorgio* principle extended a right of repayment to it as holding company of the subsidiary during the period it had overpaid VAT, because the holding company had borne the burden of that tax. The Tribunal did not accept that this was a correct reading of these cases, which provided for a primary right of repayment to the trader who had accounted for the tax, and then a secondary right to the consumer as the person who bore the economic burden of paying it if it was otherwise excessively difficult for the consumer to obtain a repayment through the supplier. An investor in the supplier was not a person who was considered to have borne a burden as a result of the operation of the VAT system.

After consideration of the arguments of all the competing parties, the Tribunal came to a relatively simple conclusion. The rights and obligations of all the members of the group were treated as falling on a single taxable person that was deemed to exist. The representative member was the person responsible for making returns, and was liable to be assessed under s.73 if returns were not filed or wrongly filed. Other members could become jointly and severally liable for the whole of the VAT, but there was no mechanism in the UK law for dividing the liability between them, nor for dividing an entitlement to a repayment. Under s.80, it was the person that had overpaid VAT that made a repayment claim; there was nothing in the law to prevent the fiction of the deemed single taxable person continuing after the VAT group had been dissolved. The FTT had been correct in *SC/Lloyds*, and wrong in *BMW/MG Rover*.

If the former representative member had been dissolved, it might be excessively difficult or practically impossible for recovery of overpaid VAT by this route, and it might then be possible for others to make a claim. However, that was not the situation in any of the cases under review.

Upper Tribunal: *HMRC v BMW (UK) Holdings Limited and anor; Lloyds Banking Group plc and ors v HMRC*

6.4.2 Assessments replaced by returns

A trader failed to file five VAT returns between 09/07 and 09/08. HMRC raised assessments which he paid; he filed the returns in August 2014, showing a liability £20,971 less. A claim for repayment was made and refused, and HMRC applied to have the appeal struck out. The judge noted that both sides approached the hearing as if it was a full appeal, rather than an application for strike-out. As they were not prepared to address the proper issue before the Tribunal, he asked for written submissions of no more than two sides of A4. The appellant submitted four sides, and HMRC only succeeded in getting their points onto two sides by using “such a miniscule font that their submissions were barely legible at an ordinary reading distance”.

The judge was clearly annoyed with both parties, and commented that he had effectively had to decide on the matter as if there had been a full hearing. Nevertheless, the decision was framed in terms of whether the appeal had a reasonable prospect of success if it did proceed to a full hearing. The taxpayer had advanced three grounds, all of which were rejected:

- that the assessments had not been raised to best judgement, because HMRC had used out-of-date formulae;
- that the illness of the taxpayer should be taken into account;
- that s.80(4) (the cap on repayment claims) did not apply where assessments had been withdrawn and replaced by returns.

The second and third points were briefly dismissed, and the first point after rather more detailed consideration. The judge concluded that there was no reasonable prospect of success and struck out the appeal.

First-Tier Tribunal (TC05408): *Patrick Doherty and another t/a D & L Contracts*

6.4.3 Repayment supplement claim struck out

A trader made a repayment claim for £92,784 in respect of his 09/06 return period. HMRC selected the return for extended verification and refused to repay nearly all the tax on MTIC grounds. After an appeal, the FTT held that there was insufficient evidence of a VAT loss in relation to £35,134, so this was repaid in 2012, with statutory interest. The trader claimed repayment supplement, which was refused on the grounds that the claim did not meet the condition in VATA 1994 s.79(2)(c). The trader appealed, and this was stayed pending an appeal on the MTIC issue to the Upper Tribunal, which dismissed the appeal in 2014. Leave to appeal further was refused by the Court of Appeal in July 2015.

HMRC applied to have the repayment supplement appeal struck out. The trader applied to have caseworkers summoned to give witness statements about how the return was processed, because he considered the description of the procedure for repayment supplement in Notice 700/58 suggested that he was entitled to it. The two applications were heard together.

The judge noted that Notice 700/58 did not have the force of law, and it was necessary for the FTT to consider the statutory provisions rather than possible arguments about the conduct of HMRC. It would be an abuse of process to allow the trader to argue again, as he wished to, that there was no error in his return: the Upper Tribunal had decided that there was, and it was clearly greater than 5%. The appeal was struck out, and the application for witness statements refused.

First-Tier Tribunal (TC05395): *Ian Charles t/a Boston Computer Group Europe*

6.5 Timing issues

Nothing to report.

6.6 Records

Nothing to report.

6.7 Assessments

6.7.1 Self-billing

In TC02548, the FTT considered a scrap metal dealer who had operated a self-billing system for VAT for many years. There were no formal agreements in place with any suppliers, but HMRC had carried out a number of visits and were well aware of how the company operated. Between 2006 and 2008, HMRC deregistered four of the company's suppliers, and subsequently assessed to disallow £337,000 of input tax claimed by the company on its self-billing invoices in respect of supplies from these suppliers.

The FTT examined the background and concluded that the absence of self-billing agreements, combined with the regular visits, meant that HMRC had exercised discretion under reg.29 to allow the company's input tax claims on invoices which did not meet all the conditions of the regulations. Given that this discretion had been exercised for so long, it was not reasonable to withdraw it in relation to these particular invoices, where the company could not have been expected to know that the suppliers had been deregistered.

The case of *Boguslaw Juliusz Dankowski v Dyrektor Izby Skarbowej w Lodzi* (Case -438/09) was referred to as authority for the proposition that a member state cannot disallow input tax just because a supplier is not registered for VAT: a trader who has received a taxable supply from a taxable person is basically entitled to deduct the input tax, unless other conditions are met (e.g. knowledge or means of knowledge of connection to fraud).

HMRC appealed to the Upper Tribunal. The judge commented that there is an important distinction to be drawn between different types of "failure to exercise discretion under reg.29":

- considering the matter and deciding that discretion should not be exercised;
- wrongly deciding that the matter was not subject to discretion, perhaps because some precondition was thought to be required and not to subsist;
- failing to consider the question of discretion at all.

In each case, the Tribunal's jurisdiction is only supervisory, because it concerns the exercise of a power that the law allows to HMRC. However, it is an appealable matter because the trader's rights of appeal about the allowance or disallowance of input tax are not restricted by s.83(1)(c) VATA 1994.

The UT judge considered the background to the decisions by the HMRC officer and the decision of the FTT. He concluded that the officer had made two decisions – the initial one, to raise the assessment, and the confirmation of that decision on review. It appeared that he had improperly regarded the absence of a self-billing agreement as a pre-condition for reg.29 discretion on his review, but had only taken it into account as a factor in his initial decision to assess. It was possible that his discretion had been correctly exercised at that point, but this had not been argued before the UT. HMRC were invited to go away and consider

whether they wished to justify that decision on the basis of a proper exercise of discretion.

If the discretion could not be justified on either occasion, it was not for the FTT or UT to exercise the discretion for HMRC, given that it was not obvious what the decision would or should have been if the power had been correctly applied. It would therefore be open for HMRC to exercise the discretion again. However, it would almost certainly now be out of time to issue new assessments if HMRC reconsidered the matter and came to the same decision on more justifiable grounds.

At a second hearing in February 2015 to clarify the effect of his decision, Warren J set out what he considered to be the correct course of action:

i) that the appellant should within a particular period of time (to be determined by the FTT) provide any further material to HMRC which the appellant wished HMRC take into consideration when exercising its discretion;

ii) that HMRC should within a particular period of time (to be determined by the FTT) revisit the issue of the exercise of their discretion upon the basis of all the materials then available to it;

iii) for the FTT thereafter, and, if necessary, in the light of any decision made by HMRC, to decide whether HMRC would be acting within the proper exercise of their powers to decide not to exercise their discretion under regulation 29(2) in favour of the appellant.

The taxpayer appealed to the Court of Appeal. Gloster LJ analysed the law and the decisions below, and commented in detail on the nature of the FTT's supervisory jurisdiction as set out by the Court of Appeal in the *John Dee* case. The Upper Tribunal had got the procedure wrong: if HMRC's decision was unreasonable (which it had decided it was), then the appeal had to be allowed unless a properly reached decision would inevitably have been the same (which neither Tribunal had decided). Remitting the matter to HMRC for further consideration preserved the existence of the defective assessment. It was open to HMRC to go back and start again, but they were surely out of time to do so. The taxpayer's appeal was allowed.

Court of Appeal: *G B Housley Ltd v HMRC*

6.7.2 Nail bar nailed

A FTT decision sets out in some detail the procedure of investigating possible understatement of takings by a nail bar. The trader hotly disputed the resulting assessments and deliberate conduct penalties, but the Tribunal judge concluded that the HMRC officers were credible witnesses and the assessments satisfied the conditions for "best judgement". Apart from a minor adjustment to some of the calculations, the appeal was dismissed.

First-Tier Tribunal (TC05391): *John Chu*

6.7.3 More best judgement

A cafe owner appealed against an assessment that was based on an investigation that suggested to HMRC that she was zero-rating too high a percentage of her takings. Again, the decision records in some detail how

HMRC arrived at their figures, and allows the appeal to the extent of a minor reduction in the assessment. Apart from that, the judge was satisfied that the assessment was justified.

First-Tier Tribunal (TC05414): *Joyce Whitfield*

6.7.4 Final resolution

A company has been through the Tribunals process in relation to whether assessments served on the wrong address were valid or could be appealed out of time (Upper Tribunal, July 2015 update). When its appeal reached the FTT for a substantive hearing, it was not represented and did not appear, but there was a letter from a new firm of solicitors applying for an adjournment on the basis that the company could not raise the finance to support representation. After some discussion, the Tribunal judge decided that the substantive hearing should proceed.

There were four decisions on VAT and two on misdeclaration penalties. The judge concluded that the burden of proof was on the taxpayer in respect of the VAT, and there was nothing in the director's witness statement that established any reason to displace any of the assessments. As regards misdeclaration penalties under s.63 VATA 1994, they automatically followed from the amounts involved, and the company had not shown any reasonable excuse.

The Tribunal dismissed the appeals, and awarded costs to HMRC on the basis of unreasonable conduct of the appeal by the company.

First-Tier Tribunal (TC05518): *Romasave (Property Services) Ltd*

6.8 Penalties and appeals

6.8.1 Default surcharge

In an article in *Taxation*, Mike Thexton reviews the lessons to be learned from a range of recent cases on default surcharge, pointing out the ways in which traders can protect themselves from suffering the penalty.

Taxation, 13 October 2016

A company appealed against a 5% surcharge of £972.11 for its period 12/14. The company had been registered for VAT since 1 April 1973, but had sold the business on 31 December 2014. This meant that all the debt and work in progress was crystallised at that point, and the VAT liability for the period was artificially inflated. After that date the company had no employees, and the sole director was taken ill. The company had always paid its VAT on time, but was on this occasion 13 days late.

In the FTT (TC04717), HMRC argued that this was a combination of "shortage of funds" and "reliance on another" (because there were no employees). The judge agreed that the company had not established any unforeseen or uncontrollable circumstances that might amount to a reasonable excuse. There was no doubt about the good compliance history of the company or the director's intention to do the right thing, but the appeal had to fail.

The company appealed to the Upper Tribunal, arguing that the FTT had applied the wrong test in deciding whether there was a reasonable excuse, and that the reasoning in the decision was not sufficient to justify the conclusion. The UT agreed that the FTT had failed properly to consider the various facts relied on by the company in its *Steptoe*-based argument – the effect of the sale of the assets and goodwill, the fact that the company no longer had any staff, the illness of the director and the fact that he had only realised the amount of VAT due when preparing the return. The failure to deal with these facts in its decision was an error of law by the FTT, which meant that the UT should set the decision aside and remake it.

Unfortunately for the company, after considering the facts, the UT came to the same conclusion: the company had failed to establish a reasonable excuse for the late payment. There was no evidence to support a conclusion that the director's illness had led to the late payment or prevented him from contacting HMRC to negotiate time to pay, or that funds could not reasonably have been raised to pay the VAT on time. The appeal was dismissed again.

Upper Tribunal: *ETB (2014) Ltd v HMRC*

A company appealed against surcharges for 12 periods from 08/08 to 02/13, totalling £6,448. The Tribunal set out a history of business difficulties with a franchisor, leading to health and marital problems for the sole director of the business. He had fallen seriously into arrears with his VAT returns, but had eventually submitted outstanding returns and brought his affairs up to date.

HMRC had withdrawn surcharges for four periods in 2011 on the grounds of the trader's illness, which meant that the SLN period ended and the next three periods were not penalised (the 2% and 5% penalties were below £400). Further defaults in 2013 were again disregarded on the grounds of illness and the impact of divorce.

The Tribunal noted the comments of Judge Medd in *The Clean Car Company Ltd v HMRC* (1991). He held that long-term illness of a sole director could be a reasonable excuse, but over time a reasonable trader would put alternative arrangements in place. HMRC's cancellation of penalties for a year at a time appeared to follow this precedent. The appeal only succeeded in relation to one period, where the judge accepted that extra pressure had been put on the trader by an intimidating meeting with the franchisor at which he had feared he would lose the business after borrowing to invest in it, at a time when he had been seriously ill. The appeal was dismissed in relation to 11 periods, leaving £5,115 payable.

First-Tier Tribunal (TC05387): *Marlin Global Services Ltd*

A company appealed against a surcharge liability notice issued for period 09/14 and a 2% surcharge of £586 for period 12/14. The payment for the SLN period was made over 3 days, £11,916 of £51,916 being received 2 days late. The payment for the second period was also paid over 3 days, but these were 84, 179 and 180 days late.

The company's basic argument was that the issue of a SLN for the late payment for 09/14 was disproportionate because it had a bank transfer limit of £20,000 and could not pay the whole amount at once, and the second default should therefore only have resulted in a SLN. At the

hearing, the company added the need to pay subcontractors on 7 November 2014 that meant the bank transfer limits applied.

The Tribunal agreed with HMRC that the correct solution would have been to ask for TTP before the due date, and the penalty was not disproportionate.

First-Tier Tribunal (TC05403): *Concryl Ltd*

A company appealed against a 15% surcharge of £2,392 for its period 07/15. The company had suffered a £150,000 bad debt in 2008 and had struggled ever since to pay its VAT on time. The company only entered the DS regime on late payment of the 07/13 liability, after at least 6 of the 12 TTP agreements. The next 6 return periods showed filing on time but late payment, with the 2% and 5% surcharges reduced to zero. Two further surcharges were cancelled (at 10% and 15%) because HMRC agreed TTP after the due date (the application having been made before the due date).

The Tribunal examined the circumstances of the particular default, which the director claimed had arisen because of late payment from a usually reliable customer. The company had had to issue a letter before action and had received some money, but most of it was late. HMRC pointed to the fact that the company had settled other debts during the relevant period: it had chosen to prioritise those payments over the VAT.

The Tribunal considered the question carefully, but had to agree with HMRC. The company was faced with a difficult choice, but it was nevertheless a choice. The insufficiency of funds arose from that choice, rather than unavoidable circumstances. The appeal was dismissed.

First-Tier Tribunal (TC05405): *MAT Services Ltd*

A company appealed against a 2% surcharge of £983 for its 12/15 period. The appeal was settled on paper; the decision is peculiar, as it states that it relates to the 10/14 period, when in fact it appears to relate to arguments about the 12/14 period (leading to a SLN) and the 12/15 period (which appears to have led to the surcharge, although the facts are not clearly stated). The 12/14 return had been filed before the due date on 27 January 2015; the tax was paid in two instalments by Faster Payments, the second being 2 days late.

The decision is given by Judge Khan, who was overruled by the Upper Tribunal in relation to disproportionality in the *Trinity Mirror* case. It is therefore not surprising that he cites that case and dismisses the appeal, which was based on little more than disproportionality. Given that the net sales were £585,000 for the quarter concerned, it would have been hard to sustain such an argument even without the clear precedents on the subject.

First-Tier Tribunal (TC05420): *South Link Ltd*

A company appealed on paper against a 15% surcharge of £1,697 for its 07/15 period. The company had ceased trading and was dormant; its appeal appeared to be based on no more than that, and Judge Khan dismissed it.

First-Tier Tribunal (TC05421): *Gelato Gelato Ltd*

A company appealed against a 10% surcharge of £865 for its 10/15 period. The problem was that its return was submitted on 8 December,

leading to late collection of the direct debit on 11 December. There was a "genuine mistake" arising from a "muddle". Judge Khan could not accept that this was a reasonable excuse, and dismissed the appeal.

First-Tier Tribunal (TC05422): *Rat Ventures LLP*

A company appealed against a 10% surcharge of £3,424 for its 02/16 period. The appeal appeared to be based solely on the unfairness of a "one size fits all" penalty for a 7-day late payment by a small company. Judge Khan cited the two recent Upper Tribunal decisions that bound him, and dismissed the appeal.

First-Tier Tribunal (TC05424): *FT Publicity Ltd*

A sole trader appealed against a 10% surcharge of £662 for his 12/15 period. The trader appeared to be a small high street solicitor's practice. His appeal consisted only of an "impassioned plea on behalf of small businesses" about the unfairness of the surcharge, which simply increases the difficulties of traders already struggling with the effects of a recession. Judge Khan could only dismiss this, noting that TTP might be of assistance.

First-Tier Tribunal (TC05427): *Peter William Mason-Apps T/A Mason Apps, Smallmans & Co*

A company appealed against a 10% surcharge of £297 for its 07/15 period. This was the first default subject to an actual financial penalty, as none had been levied at 2% or 5%. The trader's notice of appeal revealed several misunderstandings: he believed the VAT was due on 10 September (although he was not paying by DD), and he thought that any surcharge would be at 2% (even though the previous SLNs would have shown the increasing rate). He also argued that the penalty was unfair for only being a day late. Judge Connell dismissed the appeal.

First-Tier Tribunal (TC05429): *Paling Plumbing & Heating Ltd*

A company appealed against a 10% surcharge of £18,462 for its 10/12 period. The tax was paid 7 days late by CHAPS. The company pointed out that it could have, and should have, issued "applications for payment" rather than full VAT invoices when payments were due, advancing the tax point for their VAT liabilities. There was also a misunderstanding about the due date for payments, and a cash flow difficulty arising from a late payment by a major client.

The misunderstanding could not be a reasonable excuse. HMRC put forward evidence supplied about bank accounts showing that the company had enough money to pay the VAT, and in any case the late payment appeared only to relate to £72,000 and was so irrelevant to a VAT liability of £184,000. The hypothetical argument about alternative invoicing arrangements could also not be a reasonable excuse, and the Tribunal was bound by precedent on the question of fairness. The appeal was dismissed.

First-Tier Tribunal (TC05436): *Cumberland Constructions Ltd*

A company appealed against a 10% surcharge of £480 for its 06/14 period. There was a problem with one of three directors leaving the company, leading to a hiatus in VAT compliance and late submission of several returns. However, the main issue in the appeal was whether

HMRC should have issued a "help letter" rather than a SLN for the first default, which would have reduced the 10% surcharge to 5% and thereby brought the penalty under the £400 limit.

The company's turnover as calculated by HMRC (on the basis of the four returns leading up to the default period, here the four returns 06/12 – 03/13) was £151,015. There was inconsistency between this and HMRC's statement of case, which used 03/12 – 12/12, but the turnover was still over £151,000. The statutory accounts for the accounting periods ending 31 October 2011, 2012 and 2013 were all under £150,000. HMRC stated that they had a policy and had to apply it consistently. The Tribunal accepted this: the concession for small businesses is not in the legislation, and it could see no reason to displace HMRC's decision.

The departure of the director was rejected as a reasonable excuse for 06/14, because the company had had 5 months to reconstruct the records. The situation was more balanced in respect of 03/14, because the departure was more recent, but the judge considered that the company had not discharged the burden of proof. It would have helped to have witnesses to explain what efforts had been made to retrieve the records from the departed director, or what attempts had been made to contact HMRC. The appeal was dismissed.

First-Tier Tribunal (TC05453): *Sirimi Salons Ltd t/a The Red Salon*

A company appealed against a 10% surcharge of £1,244 for its 03/16 period. The trader claimed not to be aware that it was within the surcharge system, but it had successfully appealed against a previous 10% surcharge on the grounds of reasonable excuse, so it should have appreciated the consequences of another default. The rest of its appeal constituted "oversight" and "unfairness", and these could not succeed.

First-Tier Tribunal (TC05472): *Briteair Systems Ltd*

A LLP appealed against two surcharges, one of £3,165 for period 06/15, and the second of £4,942 for 09/15. The LLP was under common ownership with a limited company, Money Station Ltd, to which it supplied staff. The return periods were identical, so in any quarter the LLP would declare output tax that the other company (a pawnbroker) would reclaim.

The company provided evidence that it had instructed the bank to make the payments on or before the due dates, but the payments had only been made two or three days after the due dates. In both cases, a weekend intervened. The problem was that the payments exceeded a daily £25,000 limit for Faster Payments, so they were put through a slower system on the next working day.

By the time of the hearing, a reasonable excuse had been agreed for the very first default in the sequence because a TTP agreement was in force. The subsequent defaults were recalculated, reducing the 06/15 penalty to the figure shown above (it had previously been charged at 15%).

The Tribunal considered various explanations of the way in which the payments had been made, with the company's director and book-keeper claiming that there had been no indication on the bank's website that the instruction would not be processed on the same day. HMRC objected that an earlier problem with a Faster Payment being put through as a Bill

Payment should have alerted them; they said that they did not appreciate the implications.

The Tribunal confirmed that it was satisfied with the way the SLNs were issued, and that the reduction from 15% to 10% did not invalidate the surcharge for 06/15 altogether. The main issue was whether the company had had a reasonable expectation that the payment would arrive on time. The judge did not accept the various explanations that were given as "reasonable"; in particular, one earlier period's payment had been split in two to keep within the Faster Payments limit, so someone in the accounts department had been aware of it.

The appeal was dismissed.

First-Tier Tribunal (TC05481): *M S Resources LLP*

A company appealed against two surcharges, one of £58,633 for period 10/13, and the second of £73,728 for 01/14. The company had a financial crisis because HMRC issued a winding-up petition against its subsidiary for non-payment of Landfill Tax. As a result, it was subject to severe restrictions on access to its bank account and overdraft facilities.

The Tribunal agreed with HMRC that a shortage of funds required an underlying "reasonable excuse" to be a defence against a surcharge. The winding up petition was not unforeseeable or unexpected, as HMRC had been pursuing the debt for some time; a shortage of funds arising from the consequences of non-payment of a different tax could not be a reasonable excuse. The appeal was dismissed.

First-Tier Tribunal (TC05484): *Catplant Ltd*

A sole trader appealed against a surcharge of £20,597 for period 09/15. The trader had been in the surcharge regime since 03/08, and had been paying 15% surcharges since 12/09. The surcharges were usually modest amounts and had been paid. The company had attempted to set up a direct debit arrangement in July 2014, but it was linked to a dormant account with the wrong bank. HMRC had made several attempts to collect VAT on the DD, but had never received any money that way; the liabilities had been settled by Faster Payments, but the company had not taken action to investigate the cause of the problems. The large surcharge arose because the business premises had been sold and the VAT liability for that period was again paid late.

The judge accepted that the trader acted in good faith and had declared the VAT on time and intended to pay it; however, a reasonable trader would have made sure that the DD arrangement was in force, and the "muddle" could not be a reasonable excuse. The appeal was dismissed.

First-Tier Tribunal (TC05485): *Michael J Bromley*

A company was subjected to surcharges for the periods from 10/13 to 10/15 totalling £49,786. The appeal was brought out of time, and the Tribunal heard HMRC's objection to that application at the same time as hearing the substantive appeal. The essence of both arguments was that an employee (the husband of the daughter of the principal shareholder and director) had been given responsibility for VAT returns, and had concealed from his wife and her father (the directors and main shareholders) that he was paying other creditors in priority to HMRC.

The Tribunal rejected HMRC's contention that late appeals should only be allowed to proceed in exceptional circumstances. The application was accepted, on the basis of a weighing exercise between different factors. In fact, even if exceptional circumstances had been required, the conduct of the employee would have satisfied the Tribunal that this was met.

In the substantive appeal, the Tribunal agreed with HMRC that the matter fell within s.71 VATA 1994 – "reliance on another". The directors had relied on the employee, and that could not constitute a reasonable excuse. The apparent concealment by the employee does not appear to have been considered or referred to directly in the decision: the Tribunal held that HMRC were entitled to treat letters addressed to the directors as bringing the matter to their attention, so the fact that the directors did not see those letters was not relevant.

The appeals were dismissed.

First-Tier Tribunal (TC05495): *The Damn Yankee Ltd*

A company appealed against a surcharge of £8,639 for its 08/15 return period. The company had suffered a substantial fraud by its financial accountant, who had embezzled at least £250,000 and possibly another £400,000 – investigations were continuing. Part of the fraud had involved regularly paying the VAT liabilities late and concealing the surcharge liability notices. The surcharge rate was at 15% from 05/13 onwards.

Once the accountant had turned himself in to police and been sacked, the company employed another accountant and sought to sort out the mess. The 05/15 return was filed and the liability was paid on time, but the 08/13 liability was paid two days late. The directors claimed that the new accountant had believed that there was a direct debit facility in place; a direct debit was in place for payment of arrears, and this led to her misunderstanding. The circumstances leading to the default were exceptional.

HMRC argued that the direct debit for the arrears was not set up until later. They suggested that the new accountant, in the circumstances of taking over after a fraud, should have taken all necessary steps to ensure that the next VAT return and payment were submitted on time. It appeared more likely that the VAT liability was held back by the company until after a substantial receipt had been credited.

The Tribunal noted that the new accountant had not given evidence – her "misunderstanding" was the directors' interpretation of the reasons for the default. The Tribunal did not consider it a reasonable misunderstanding, if indeed that was the reason. She had dealt with the 05/15 return and had had to specifically request the payment from the directors, so she should not have believed that a direct debit was in place.

Reliance on an employee, whether the new accountant or the fraudulent one, could also not constitute a reasonable excuse. The "exceptional circumstances" of the fraud also did not seem to have caused the default: according to the directors, it was not the loss of the money but the new accountant's misunderstanding that led directly to the late payment. That had already been ruled out, so the appeal was dismissed.

First-Tier Tribunal (TC05500): *Eurovision Logistics Ltd*

A trader appealed against a 10% surcharge of £704 for the 12/15 period. The business had been registered since 1 April 1993 and had been in the surcharge regime since 12/13. The payment was a week late, and the defence offered amount to no more than "disproportionality" and "pressure of work". The appeal had to be dismissed.

First-Tier Tribunal (TC05536): *Brian Hattam and another t/a EDF (UK)*

A company appealed against five surcharges from 06/13 to 06/14 totalling £4,996. The company disputed whether it had received the relevant surcharge liability notices. The Tribunal noted that HMRC had no direct proof, but a number of circumstantial factors suggested that it was more likely than not that the SLNs had been sent. However, there was also circumstantial evidence that suggested they had not arrived; in particular, the employee who dealt with VAT had rung HMRC in a succession of earlier periods to discuss Time To Pay; the fact that she did not do so in respect of any of these periods supported the presumption that she had no reason to suppose that she needed to.

The employee mainly argued about proportionality, but that could not assist the company. The Tribunal found that there was no reasonable excuse for any of the defaults, nor was there a Time To Pay agreement in place. However, the straightforward evidence of the employee supported the conclusion, the significance of which she plainly did not realise, that no SLN had been received. The appeals were allowed on that basis.

First-Tier Tribunal (TC05543): *Kusten Vorland Ltd*

6.8.2 Misdeclaration

A firm appealed against two misdeclaration penalties, one for £507,000 for 05/06 and one for £157,000 for 06/06. The grounds of appeal were that the assessments had been notified after the two year time limit, and that HMRC had failed to follow its own guidance on assessment and notification. HMRC responded that the assessments had been raised in time, and the admitted failure to follow their own procedures could only be challenged by an application for judicial review.

The penalties were in relation to returns which claimed input tax that was refused on MTIC grounds. The penalties were raised within two years of the withdrawal of appeals against that refusal, which took place on 27 June 2013. The assessments were raised on 11 June 2015, reviewed by another officer on 23 June, and sent out the same day. The Post Office did not deliver them because HMRC had put too little postage on a "large letter" – instead, a note was delivered to the company office (the firm had been incorporated) saying that the letter would be delivered on payment of £1.11. A director paid this by credit card and the letter was delivered on 30 June 2015, more than two years after the withdrawal.

The Tribunal had to decide four issues:

- when the VAT on the returns was "finally determined" – it concluded that this was the date the appeal was withdrawn, not the date that was confirmed by the Tribunal or a judge;
- when the penalties were notified – there was some confusion in the original notices, so the proper notification was completed by a letter

of apology from the officer on 27 August 2015, clarifying to whom the penalties were addressed;

- whether the time limit is determined on the raising of the assessment or the notification to the taxpayer – the judge followed precedent (after a very detailed examination) and concluded that it should be the date the assessment was raised;
- whether HMRC were bound by their published guidance that in applying assessing time limits, they would rely on the date of notification rather than the date of assessment – the judge agreed with HMRC that this did not fall within her jurisdiction, but would have to be the subject of an application for judicial review.

Overall, therefore, HMRC won.

First-Tier Tribunal (TC05523): *Teletape (a firm)*

6.8.3 Belated notification

A company appealed against a decision that it should be registered from 1 July 2003 to 31 July 2008 and the resulting VAT liability and belated notification penalty. The appeal was brought considerably out of time (over two years after the decision), but the Tribunal (after consideration of the *Data Select* principles) granted permission for the appeal to proceed.

The Tribunal noted that there had been a considerable delay on HMRC's part in pursuing the matter – between 2009 and 2012 they had failed to contact the trader. Nevertheless, in a late notification case their two years to assess ran from the date on which the tax was determined, which in this case fell in 2013, not in 2008. The taxpayer's appeal on the basis of the time limit was dismissed. The decision to register, the liability and the penalty, including the 50% mitigation allowed by HMRC, were all confirmed.

First-Tier Tribunal (TC05490): *SNAR Associates Ltd*

6.8.4 Other penalties

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 judge made various directions about the future conduct of the appeal.

First-Tier Tribunal (TC05508): *Lindsay Hackett*

A company appealed against HMRC's refusal to suspend a £19,800 penalty for a careless inaccuracy in the 12/13 return. The penalty was reduced to £11,800, but HMRC still refused to suspend it. The company had registered for VAT and reclaimed input tax, but HMRC discovered that it only made exempt supplies. It subsequently joined a VAT group registration, which meant that it was validly registered; HMRC ruled that the penalty could not be suspended because suspension conditions cannot be transferred to a different VRN.

On appeal, the company argued that HMRC were not correct to view the provisions of FA 2007 Sch.24 para.14 as applying to entities as defined by VAT registration numbers. The legislation referred not to VAT registration numbers but to persons, which included the appellant as a company. It was not correct that the appellant ceased to exist as a legal entity or a company as a result of becoming a member of a VAT group.

HMRC responded that the legislation referred to "P" as the person on whom conditions should be set. If the VAT registration changed, conditions would not be set on the same person. In addition, this appellant continued not to make any taxable supplies, so no conditions could be set for it. The first of these reasons appeared to be the conclusion of HMRC's review, whereas the second was the original reason for refusal given by the officer who made the initial decision.

The original officer's decision failed to take account of a relevant change of circumstances – joining the VAT group. That made it a flawed decision. The Tribunal considered that the appellant's interpretation of the rules about "P" were to be preferred: there were no insurmountable obstacles to setting conditions for a company as part of a group.

The refusal to suspend was rejected for three reasons: HMRC's misunderstanding of the consequences of joining a VAT group; the logical inconsistency of maintaining that the appellant was liable for the penalty (i.e. continued to exist) but had ceased to exist for the purpose of suspension conditions; and the internal inconsistency between the reasons given for refusal initially and on review. The Tribunal ordered HMRC to suspend the penalty, although presumably that ought to depend on setting and agreeing some conditions.

First-Tier Tribunal (TC05528): *Parklane UK Investments Ltd*

6.8.5 Participating in VAT fraud

HMRC have run a consultation on a new penalty for people who knew or should have known that their transactions were connected with VAT fraud. The idea is that it will be easier for HMRC to levy a single penalty in advance of a "*Kittel*" hearing because the penalty will not depend on whether the Tribunal finds that the taxpayer actually knew ("deliberate behaviour") or should have known ("careless behaviour") about the connection to fraud.

http://tinyurl.com/hhkdopj

HMRC have published a TIIN on the VAT penalty for participating in VAT fraud. It states that the exchequer impact is expected to be negligible.

TIIN 5 December 2016

In an article in *Taxation*, Richard Curtis discusses the above consultation document.

Taxation, 20 October 2016

In the same issue, Robert Maas complains that a proposal derived from the problem of Missing Trader Inter-Community fraud appears to have much wider potential application, possibly affecting ordinary transactions where people would in the past have been very unlikely to suffer a VAT penalty (such as paying a builder without demanding a VAT receipt).

Taxation, 20 October 2016

6.8.6 Payment before appeal

A company was assessed to £1.4m of input tax it had claimed in circumstances HMRC alleged related to MTIC fraud. The company disputed whether it should be required to deposit the tax before an appeal could be heard. The UT dismissed this appeal in 2014, but the company was granted leave to appeal to the Court of Appeal on the grounds of a new legal argument, that the requirement to deposit disputed tax infringed the EU legal principle of equivalence. The company argued that deposit of tax is not required for income tax or SDLT appeals.

Lady Justice Arden gave the leading judgment, dismissing the appeal. She set out several differences between VAT appeals and other tax appeals in relation to:

- prepayment of tax (only required for VAT);
- hardship applications (only available for VAT, but held not to be available to this appellant);
- postponement applications (relevant to direct taxes);
- taxpayer appeals to the Upper Tribunal from the FTT (which will generally require payment of tax that the FTT held to be due).

She cited Lord Hope's statement of the equivalence principle from the case of the FII Group Litigation: "The principle of equivalence requires that the rules regulating the right to recover taxes levied in breach of EU law must be no less favourable than those governing similar domestic actions."

The matters in dispute included what actions and taxes could be regarded as "similar" for this purpose. The judge referred to the 'no "most favourable treatment" principle', by which she meant that equivalence did not require an EU-based claim to enjoy the most favourable of any available regimes in domestic law; it was permitted under EU precedent for there to be a range of different comparators and for the equivalent claim to fall within them, rather than always enjoying the most favourable.

She said that this was enough to dispose of the appeal, but she went on to conclude that VAT appeals were not similar to other tax appeals for the

purpose of the equivalence test, and identified specific points from precedent CJEU cases that supported this approach.

The appeal was unanimously dismissed.

Court of Appeal: *Totel Ltd v Revenue and Customs Commissioners*

6.8.7 Appeal out of time

A company appealed extremely late against Corporation Tax late filing penalties from 1999 to 2004, and against an assessment raised in December 2013 for periods 04/11 to 04/12. The only ground for applying for a late appeal appeared to be that the assessments had not been received by the appellant, but correspondence appeared to suggest that the director had been aware of the liability. There were no good reasons for delay, and considerable prejudice to HMRC if the appeals were allowed to proceed. The application was refused.

First-Tier Tribunal (TC05498): *C R Vending and Electronics Ltd*

A company applied for permission to appeal out of time. HMRC had issued a review decision on 5 September 2014 confirming a decision to deny VAT credits for three periods in 2011 and 2012, and the company only appealed on 28 July 2015, over 9 months late. During the intervening period the company directors had written repeatedly to HMRC's debt management department, continuing to dispute the decisions and the department's attempts to collect the tax. HMRC filed a winding up petition, of which the company's solicitors applied for an adjournment, before finally a formal appeal notice was submitted.

The Tribunal considered the company's explanations at length, and went through the *Data Select* criteria. The judge considered that the appellant had been warned repeatedly of the opportunity and method of appeal, and had no good explanation for its long delay. The application to appeal out of time was rejected.

First-Tier Tribunal (TC05540): *AGM (Riverside) Ltd*

6.8.8 Costs

A company supplied pitches and league management services for small-sided football. It had accounted for VAT on the basis that all its supplies were standard rated, but following the Tribunal's decision in *Goals Soccer Centres plc* (TC02253), it made a claim for repayment which HMRC refused. The company appealed. HMRC were in the meantime engaged in a review of their policy in this area which led to the issue of a R & C Brief in February 2014 and the settlement of the appeal. The company claimed that HMRC should have informed it about the review and stayed the appeal, and asked for costs.

HMRC had written to the company in October 2013, setting out their policy following *Goals*. There were differences between the contracts in the two situations, and this letter appeared to be an invitation for the company to negotiate a settlement on the basis that it was making multiple supplies. The appellant did not take it as such an invitation, and only introduced the multiple supply aspect in revising its statement of claim some time later.

The FTT concluded that HMRC had not acted unreasonably in not applying for a stay of proceedings while carrying out the review, so the company's application for costs failed. Even if he had decided that they had been unreasonable, Judge Cannan would not have awarded costs, because he felt that the appellant had failed properly to engage with the October letter. If it had done so it could probably have reached the eventual settlement earlier.

First-Tier Tribunal (TC05464): *Football Mundial Ltd*

In TC04851, the FTT was highly critical of the way in which HMRC presented their case, suggesting that if they appealed to the Upper Tribunal and won, the Upper Tribunal should not award costs to HMRC because they ought to have presented their arguments better in the FTT and settled the matter there. After winning in the FTT, the taxpayer applied to the Upper Tribunal for a Protective Costs Order, determining in advance that they would not have to pay HMRC's costs even if they lost in the Upper Tribunal. Judge Sinfield considered the application in detail, and reviewed the law and practice in relation to various types of costs order, and declined to make any order. He awarded HMRC the costs of resisting the appellant's application.

Upper Tribunal: *HMRC v TGH (Commercial) Ltd*

A company made a *Fleming* claim for a refund of £2.1m of VAT incurred from 1973 to 03/08. HMRC refused the claim on the basis that the company's supplies were exempt, and the company appealed. HMRC filed a statement of case on 6 September 2010, maintaining the "exempt supplies" argument and not mentioning unjust enrichment. In 2011 the appeal was stayed behind *British Association of Leisure Parks Piers and Attractions Ltd*. Further decisions were appealed. The Upper Tribunal found against the taxpayer in the lead appeal, holding that such associations could not refund overpaid VAT to their members – implying that an unjust enrichment defence would succeed. No further action was taken by either party until late 2015, when the Tribunal asked the appellant whether it still wanted to proceed. It confirmed that it did, and directions were issued in April 2016. The company wrote to the Tribunal in July 2016 withdrawing the appeal, stating that it had just been notified by HMRC that its statement of case would be amended to include unjust enrichment as a defence.

HMRC applied for costs of £4,625. The case had been categorised as complex and HMRC had been successful. The appellant objected. One of its grounds was that it had objected to the complex categorisation; Judge Mosedale considered this a "novel" ground, but was not persuaded by it. The company had been notified of the categorisation and its consequences, and had been given the opportunity to opt out of the costs regime. It claimed that it had misunderstood whether this would succeed, believing that the amount of money at stake would lead to HMRC successfully objecting to a withdrawal from costs. The judge did not know how or why this misunderstanding arose, but she did not consider it reasonable.

The company also argued that HMRC had acted unreasonably in not raising the unjust enrichment defence until so late in the proceedings, when it should have known that it was relevant from 2013 onwards. The judge considered that HMRC did not act unreasonably at all up to the

releasing of the stay on the appeal in late 2015, as they would not have had to think about it. They should have considered the relevance of the defence by 31 March 2016, but so should the taxpayer. She concluded that both sides had acted with equal unreasonableness, so there was no reason to depart from the normal principle that costs followed the event in a complex case.

First-Tier Tribunal (TC05513): *British Security Industry Association Ltd*

6.8.9 Hardship

A company was assessed to VAT of £8.9m on the basis that it should have been registered from 1 April 2012 to 30 June 2015. There was also a smaller assessment to excise duty. The company appealed, and applied for the appeal to be heard without payment of the dispute tax on the grounds of hardship.

HMRC also applied to have the appeal struck out on the basis that no return had been filed for the period. On the day before the hearing the company produced a single page return covering the whole period and declaring that no taxable supplies had been made. HMRC accepted that this was a valid return for the purpose of allowing the appeal to proceed.

The Tribunal heard evidence from the owner of the company under cross-examination. There was little evidence available about the company's resources; although the amount demanded was a substantial amount of money, it was still necessary for the appellant to provide the evidence to support a hardship application, and it had not done so. An argument that the owner was not able to obtain the information was rejected as irrelevant. The application for hardship was rejected, so presumably the appeal will move to a substantive hearing on payment of the tax, or it will be struck out if the tax is not paid.

First-Tier Tribunal (TC05455): *Sintra Global Inc*

6.8.10 Information notices

A company appealed against a penalty for failure to comply with an information notice issued on 6 March 2015 under FA 2008 Sch.36 para.1. The only ground for appealing against a penalty is a reasonable excuse for failing to comply with the Notice (Sch.36 para.45). The company had not appealed against the issue of the Notice, nor had it complied with it.

The company's grounds of appeal did not refer to any reasonable excuse, but rather objected to the Notice itself, arguing that the requested bank statements were not "statutory records". The company's accountants had argued this point from March 2015 onwards, claiming that they did not use the bank statements to prepare the VAT account so they were not "business records" for the purposes of Sch.36. Nevertheless, the decision to impose a penalty was confirmed on review.

It seems that the basis of the objection was that the company used a "family" bank account in common with personal transactions and several other businesses run by connected persons. This account was the only account used by the several businesses and individuals because they could not open more accounts, having poor credit ratings.

The Tribunal examined the legislation on statutory records, and concluded that a bank account through which business takings passed was a fundamental part of that business, and the statements recording those transactions would be statutory business records. The accountants said they did not use the bank statements or even carry out a reconciliation, but the FTT said that this was a basic procedure required to produce proper and reliable accounts and returns.

The penalty was confirmed, and there is no right of appeal against such a decision of the FTT.

First-Tier Tribunal (TC05383): *Shimlas Ltd*

Another company appealed against several fixed penalties of £300 and daily penalties that had built up to several thousand pounds in relation to VAT periods in 2013 and 2014. In total there were eight appeals against a variety of Notices, penalties and confirmatory review decisions.

The company had been told that it had entered into transactions with a trader that had been deregistered, and that as a result all of its input tax records might fall to be verified. It disputed whether due diligence paperwork and transportation records fell within the definition of statutory records, submitting that only the following would be statutory records relating to VAT – records evidencing:

a. the quantum of business done both in terms of goods/services purchased or otherwise acquired and good/services sold or otherwise disposed of;

b. the nature of the goods purchased/acquired and sold/disposed of.

c. the dates of all respective purchases/acquisitions and sales/disposals.

d. the price paid for the goods purchased/acquired and the price received in respect of all sales/disposals.

The appellant argued that the due diligence paperwork would only become relevant if HMRC had actually disallowed the input tax and there was an appeal against a *Kittel* decision. The judge did not agree: given the warning that HMRC had issued, the trader would have to take a view on the entitlement to input tax, and the due diligence records would therefore be part of the preparation of the VAT returns. They were statutory records, and the Tribunal held that they were reasonably required by HMRC for the purpose of checking the returns.

The Tribunal confirmed the penalties, and struck out appeals against the Notices themselves – having found that the documents demanded were statutory records, the Tribunal had no jurisdiction to hear an appeal against the requirement to produce them.

First-Tier Tribunal (TC05459): *Drinks Stop Cash & Carry Ltd*

6.8.11 Reinstatement and strike-out

In relation to the second MTIC appeal reported at 5.8.4, the judge heard a strike-out application from HMRC shortly before the substantive hearing started in March 2015. The appeal had already been struck out by Sir Stephen Oliver in 2008, reinstated by Judge John Briggs in the Upper Tribunal in 2010, struck out again by Judge Greg Sinfield in 2013 for failure to comply with an "unless" order, and reinstated again by Judge Mosedale in 2014. The company applied for a number of directions,

including permission to cross-examine a long list of HMRC witnesses, amend its grounds of appeal and introduce new exhibits. HMRC applied for the appeal to be struck out on the basis that the company had been so uncooperative with the Tribunal process. Judge Brannan refused all the applications, and proceeded to the hearing on the basis that the company would only be allowed to cross-examine a shorter list of witnesses agreed with HMRC.

First-Tier Tribunal (TC05442): *ATEC Associates Ltd*

An appeal was struck out on 22 February 2010 on the ground that the appellant had been dissolved and was therefore not able to proceed with its appeal. The appeal had been made by the company's representatives who asked for it to be stood over behind a lead case on the same issue, and notified HMRC that they were applying to have the company reinstated to the register. The advisers did not receive notice of the strike-out application or the Tribunal's ruling in 2010, and did not take any further action after the company was restored to the register because they believed the appeal was simply held over. It was only when the advisers started to negotiate settlements in respect of a number of its clients with similar appeals, that they were told that the appeal had been struck out years before. They promptly at that point applied for the appeal to be reinstated.

The judge noted that this was some six years late. It was regrettable that the advisers had not notified the Tribunal in 2011 when the appellant was restored to the register, but nevertheless that was understandable and not a major mistake. There would be prejudice to HMRC in allowing the appeal to proceed, but not great prejudice as they were already dealing with similar issues in relation to other companies. It was outweighed by the considerable prejudice to the company if the appeal was dismissed. The judge reinstated the appeal, and noted that it remained stayed behind the lead case. He directed that the appellant should provide to HMRC such documents as they reasonably request as regards the grounds for the appeal and the claim which underlies it.

First-Tier Tribunal (TC05439): *Hattons (Southport) Ltd*

A taxpayer did not attend a hearing of an application by HMRC to have his appeal struck out because it had been made out of time and had no reasonable prospect of success. Judge Mosedale examined the documentary account of the grounds of appeal and agreed with HMRC on both points: the appeal was made out of time without a reasonable excuse, and none of the grounds of appeal appeared to amount to a relevant argument against HMRC's decisions. The appeals were struck out on the grounds of being made out of time, but would also have been struck out on the other ground had it been necessary to do so.

First-Tier Tribunal (TC05469): *Danger Money Records Ltd*

HMRC applied to have an appeal struck out on the basis that they had not yet made an appealable decision. The appellant argued that a letter sent on 14 January 2016 did contain a decision. The company had in 2010 implemented an arrangement whereby customers from other member states could order mail order goods and arrange for delivery themselves (often using a connected company). The company asked HMRC for confirmation that this would avoid the distance selling rules and UK VAT

would be due rather than foreign VAT. HMRC agreed, but suggested that the company should contact the authorities in other jurisdictions to confirm that they were also content with the arrangement (which seems less likely).

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

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

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

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

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

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

First-Tier Tribunal (TC05445): *Sportsdirect.com Retail Ltd and another*

6.9 Other administration issues

6.9.1 The VAT guide

HMRC have issued an updated version of the main VAT Guide, replacing the April 2015 version. The main change is the clarification of the policy with regard to recovery of pre-registration VAT, as explained in *R & C Brief 16/2016*.

Notice 700

6.9.2 Autumn Statement 2016

Draft clauses for the Finance Bill 2017 were published on 5 December 2016, covering among other things the penalty for enablers of tax avoidance schemes that are later defeated by HMRC. Specific VAT measures include the implementation of the Fulfilment House Due Diligence Scheme, tackling abuse of the relief for adapted cars for wheelchair users, and the changes to the Flat Rate Scheme.

Further clauses will be published in January to cover Making Tax Digital and some other direct tax measures. There will also be a consultation on reform of the VAT Avoidance Scheme Disclosure Regime, with a view to changes in the FB 2017.

In the longer term, the digitisation of the Retail Export Scheme is set to be introduced over the period 2018 to 2020.

www.gov.uk/government/news/finance-bill-2017-government-legislates-for-new-tax-changes

In an article in *Taxation*, Richard Curtis reviews the VAT and indirect tax changes announced in the Autumn Statement. He concludes that there were no wide-ranging changes, but the rules on “limited cost traders” will have a significant impact on many small businesses registered to use the Flat Rate Scheme.

Taxation, 15 December 2016

6.9.3 Tax gap

HMRC have announced that the difference between the amount of tax theoretically due and the amount collected fell in 2014/15 to its lowest-ever level of 6.5%. It was 8.3% in 2005/06. At £12.7bn, VAT contributes 35% of the total tax gap, but is the highest category by tax at 10.3% of VAT theoretically due. This is still the lowest level it has been for several years, and again is considerably less than it was in 2005/06.

www.gov.uk/government/uploads/system/uploads/attachment_data/file/561312/HMRC-measuring-tax-gaps-2016.pdf

6.9.4 Office of Tax Simplification

The OTS has published the terms of reference for a simplification review of the VAT system. The review will include:

- registration thresholds;
- definitions of supplies subject to exemption or reduced rates;
- a formal ruling system;

- simplifying partial exemption, option to tax and capital goods scheme;
- special accounting schemes;
- penalties and appeals; and
- scope for alignment with other taxes as part of MTD. The review will not include a fundamental reassessment of VAT rates.

The OTS aims to report in the autumn of 2017.

www.gov.uk/government/collections/ots-review-of-value-added-tax

6.9.5 Serial tax avoidance – warning notices

HMRC have issued a factsheet concerning the "serial tax avoidance" legislation introduced by FA 2016 and warning notices HMRC may issue to users of tax avoidance schemes that have been defeated. A warning notice remains in place for 5 years, during which the taxpayer will be subject to special measures, including penalties. The legislation applies to schemes defeated on or after 6 April 2017, where the taxpayer entered into the scheme on or after 15 September 2016.

CC/FS38

6.9.6 Failure to prevent evasion

HMRC have published a summary of the responses to their draft clauses and guidance, released for consultation in April, on the new corporate criminal offence of failure to prevent facilitation of tax evasion. The legislation is now contained in the Criminal Finances Bill and provides for two distinct offences, one for domestic and the other for foreign tax evasion. HMRC have also published a revised version of the guidance, which will remain draft until the Bill is enacted.

www.gov.uk/government/consultations/tackling-tax-evasion-a-new-corporate-offence-of-failure-to-prevent-the-criminal-facilitation-of-tax-evasion

6.9.7 Fulfilment houses

HMRC have issued a TIIN on the Fulfilment house due diligence scheme that is to be implemented from 1 April 2018.

TIIN 5 December 2016

It is reported that the Public Accounts Committee will investigate the alleged £1bn to £1.5bn tax and VAT losses from online selling through Amazon, eBay and other sites.

The Guardian, 21 December 2016

6.9.8 Labour providers

HMRC have issued guidance to businesses that use labour supplied by a third party. It says that HMRC continue to find non-compliance, illegal working practices and fraud in labour supply chains across business sectors. Businesses should protect themselves from financial and reputational risk by undertaking checks to understand:

- where their workers are coming from;
- how they are being paid;
- the legitimacy of those arrangements.

The detail of checks is not prescribed because it will depend on the particular circumstances. However, HMRC suggest that the areas to cover are to ensure:

- the supplier of labour is legitimate and has no history of non-compliance;
- the business understands and approves the labour supply chain;
- agency workers are paid their contractual rate and it complies with the National Living Wage (NLW)/National Minimum Wage (NMW);
- the business is doing all it can to eradicate modern slavery and illegal working in your supply chains.

There are warnings about a number of possible consequences of failing to carry out such checks, of which disallowance of VAT on *Kittel* grounds is only one.

www.gov.uk/government/publications/use-of-labour-providers

6.9.9 HMRC fraud investigation service

HMRC have updated their guidance on how their fraud investigation service carries out civil investigations in certain cases not selected for the contractual disclosure route under COP9. It replaces the August 2014 version. It explains how an investigation will proceed, and the different possible outcomes with regard to prosecution and financial settlements.

COP8

6.9.10 MTIC director disqualified

A director of a mobile phone wholesaler was found by the High Court to have caused the company to enter into transactions connected with fraudulent evasion of VAT, and was barred from acting as a director for 15 years. The fraudulent claims amounted to £19.3m in March to June 2006.

Insolvency Service Press Release

6.9.11 European Communities Act

The Secretary of State for Exiting the European Union has announced government plans to repeal the European Communities Act 1972 (ECA 1972). A new Bill will give direct effect to all EU law and will mean ECA 1972 ceases to apply from the day the UK exits the EU.

www.gov.uk/government/news/government-announces-end-of-european-communities-act

6.9.12 HMRC records management policy

HMRC have published their policy on management, retention and disposal of records, including those records managed by third parties on

HMRC's behalf. The standard retention period for HMRC records is 6 years plus one for the current year. The maximum retention period is 20 years, with an additional one year for final review.

www.gov.uk/government/publications/hmrc-records-management-and-retention-and-disposal-policy

6.9.13 Articles

In an article in *Taxation*, Neil Warren describes the assessment procedure arising in a recent compliance visit where the officer appeared concerned to assess, but in the end the trader did not incur a VAT cost. The author is not sure whether the procedures used were technically correct, but the trader had no incentive to object.

Taxation, 17 November 2016

In an article in *Taxation*, Michele Harris notes a shift in HMRC's approach to visiting traders. She suggests that they are now sending teams covering several taxes on unannounced visits; these officers may be unaware of their legal status and poorly trained. She notes that the old VATA 1994 Sch.11 powers of Customs officers to carry out inspections were repealed and replaced with lesser powers in FA 2008 Sch.36. It is therefore important for the business to question the legal basis of any attempt to carry out an unannounced visit.

Taxation, 1 December 2016

In an article in *Taxation*, Ben Jones and Anisha Polson review the direct tax implications of Brexit for small and medium-sized British enterprises. The indirect tax and customs duty changes are obviously significant, but the authors suggest that the direct tax implications should not be forgotten.

Taxation, 27 October 2016

6.9.14 Statistics

The HMRC Value Added Tax Bulletin is published quarterly, containing details of VAT receipts and the number of traders registering and deregistering. The "live trader population" appears to be at a record high and growing, which – according to the report – "may be due to the improving economic situation in the UK". It may also be due to "aggressive abuse of the flat rate scheme".

https://www.uktradeinfo.com/Statistics/Pages/TaxAndDutybulletins.aspx

6.9.15 Updated Notice

HMRC have issued a revised (October 2016) edition of their Notice *Insolvency*. The address of the VAT 427 processing team has been updated.

Notice 700/56

6.9.16 Making tax digital

The CIOT and ATT have called on the government to delay the implementation of "Making Tax Digital", which is set to apply to all income tax traders with income above £10,000 from April 2018. It will

apply to VAT a year after that. The professional bodies' response was based on the results of a survey of a large number of members. They are concerned that the change will lead to significant burdens on business, and neither HMRC nor the profession will be able to provide the help that taxpayers will need to comply with the new rules.

www.tax.org.uk/media-centre/press-releases/press-release-tax-professionals-call-delay-compulsory-digital-record

6.9.17 Security

A trader appealed against a notice of requirement to deposit security of £46,760 (or £43,560 for monthly returns). The notice was served in February 2015, and confirmed on review in January 2016, but the appeal was only heard in August 2016 – in the meantime, the requirement would be suspended.

A tax consultant appeared for the appellant, putting forward three lines of argument:

A. The original decision to serve the Notice requiring security was flawed because the Respondents had not entered into any prior consultation with the Appellant;

B. The Notice was unreasonable in view of the Appellant's level of profit, and in light of the Government's policy with regard to small businesses; and

C. The review decisions could not be fair because they had been undertaken by employees of the Respondents.

The FTT examined the history of the business in some detail. It was a taxi firm that had taken over the activities of a predecessor that had gone into liquidation owing HMRC some £65,000. Its compliance had not been good. The judge noted that HMRC are not required to enter into a dialogue with the taxpayer before requiring security, so the first line of argument was not well founded. Indeed, once the trader had asked for a review, the information it provided was not sufficient to change the decision, so it seems unlikely that such a dialogue would have helped.

The second strand was irrelevant because security is based on the likely amount of VAT payable, not the trader's profit; and the third strand argued that in principle the system of statutory reviews was flawed, which the Tribunal could not accept. In addition to the unlikeliness of accepting such a criticism of a system set up by Parliament, the mere existence of a right to a statutory review could not undermine the reasonableness of the original decision.

The appellant failed to convince the judge that there was anything about the decision that was so unreasonable that no body of Commissioners could have reached it. The appeal was dismissed.

First-Tier Tribunal (TC05400): *Ashley David Transfers Ltd*

A company appealed against notices of requirement to deposit security for PAYE, NIC and VAT. It was owned by the son of a member of a partnership that appeared to have transferred its restaurant business to the company. When HMRC discovered this, they very quickly issued notices of requirement to the company, because the partnership owed significant

amounts of tax. The company appealed, arguing among other things that it was independent of the partnership and that HMRC ought to have waited until the first VAT return was submitted to see if the trading levels were the same.

The judge held that the HMRC decision could not be said to be unreasonable. If the company had now submitted VAT returns and had built up a good record of compliance, it could ask HMRC to withdraw or reduce the security requirement. The appeal was dismissed.

First-Tier Tribunal (TC05533): *Highlake Ltd*