VAT UPDATE
JANUARY 2009

Covering material from October – December 2008

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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:

Note that the HMRC website now includes some information about pending appeals, described as follows:

"*This section is aimed primarily at Tax Practitioners and has been introduced to highlight HMRC VAT appeals in respect of Tribunal decisions, and appeals by either party in respect of decisions in the High Court or above. The VAT Appeal Updates document will be updated on a monthly basis and finalised cases will be retained for viewing for two months before their removal.*"

VAT Appeals Update on www.hmrc.gov.uk/library.htm

Awaiting the ECJ:

- *Baxi Group plc*: whether a promotion scheme created recoverable input tax for the company using the scheme on the cost of goods supplied to participating plumbers (this appeal will be heard with *Loyalty Management UK*, below)
- *JD Wetherspoon plc*: whether the taxpayer is entitled to round the VAT on individual sales down (the Tribunal has not reported the UK appeal, but the ECJ has given it a number Case C-302/07, Advocate-General's opinion in this update)
- *Loyalty Management UK Ltd*: whether the promoters of the Nectar scheme were entitled to deduct input tax on "redemption services" supplied by participating retailers (HMRC were granted leave to appeal to the House of Lords in April 2008; R&C Brief in this update concerning the treatment of similar transactions by affected traders: points out that the Lords have decided to refer questions to the ECJ)

- *Royal Bank of Scotland plc*: whether the taxpayer is entitled to round the percentage up in a special method (questions referred by the Court of Session, Case C-488/07, hearing expected 8 October 2008)

UK appeals awaiting hearing:

- *BMW AG*: HMRC's decision to align return periods where a cash flow advantage accrued to an exporting company (HMRC have applied for leave to appeal to the CA – HC decision covered in this update)
- *Boots Co plc*: treatment of "voupons" (HMRC's appeal to the HC – Tribunal decision covered in this update)
- *EMI Group plc*: whether UK rules on small gifts in course of business are in accordance with art.5(6) 6th Directive, and whether absence of transitional period in the law renders the capping rules ineffective (questions for referral are still being disputed; meanwhile, HMRC are appealing the latest of a string of Tribunal rulings to the HC)
- *Livewire Telecom Ltd*: whether a person involved in "contra-trading" was entitled to input tax recovery (HMRC have appealed to the HC)
- *Premier Food (Holdings) Ltd*: remitted to Tribunal following HC's explanation of errors of law in applying the definition of "confectionery"
- *RBS Deutschland Holdings GmbH*: effectiveness of scheme to avoid charging VAT on cars leased to UK customers (HMRC appeal to Court of Session, hearing 11 – 12 November 2008).
- *Scottish Equitable plc*: effectiveness of capping provisions (it has been reported that the Court of Session has decided to refer questions to the ECJ, although HMRC's list of appeals still shows this as awaiting the Court of Session)
- *Weald Leasing Ltd*: artificial leasing arrangements and abuse of rights (HMRC's appeal to the CA to be heard w/c 24/11/08)
- *WHA Ltd/Viscount Reinsurance Co Ltd*: whether the "offshore loop" plan was an abuse of rights (taxpayer has been granted leave to appeal to the House of Lords; Lords have stood the appeal over pending a potentially relevant infringement case in the ECJ)

In this update from previous lists:

- *Canterbury Hockey Club*: whether sports affiliation fees are exempt (questions referred by HC to ECJ: Case C-253/07)
- *Royal Bank of Scotland plc*: whether HMRC was entitled to refuse a special method that gave rise to 50% recovery of residual input tax (HMRC's appeal to the Court of Session succeeded)

2. OUTPUTS

2.1 Scope of VAT: linking supplies to consideration

2.1.1 Car parking charges

HMRC have issued a Brief explaining that they have changed their view of the VAT liability of some penalty charges levied by car park operators. Previously they believed that all payments by those parking cars would be VATable. Now they accept that some payments are not consideration for parking the vehicle but are rather penalties for breach of contract, which are outside the scope.

HMRC draw a distinction between:

- charges which reflect extra consideration for extra time, for example where the "penalty" for exceeding time paid for is clearly displayed at the time the vehicle is parked; and
- charges which are purely a penalty, for example for parking in a disabled bay without proper authority, parking across the lines of bays, and not displaying a ticket.

Where a car park operator has accounted for VAT on such charges, a claim for repayment can be made, subject to the three-year cap and a possible unjust enrichment argument (although it is not clear how that would apply to penalties, where there can hardly be a "market rate" – the customer does not intend to pay them).

HMRC make the interesting observation that some car park owners allow sub-contract operators to keep any penalty charges. In that case, HMRC believe that the payments are VATable consideration within the contract between the landowner and the operator, rather than being outside the scope. It may nevertheless be possible to argue that there should be a repayment of VAT to the landowner, because:

- the customer has paid an amount which should not be subject to VAT;
- presumably the landowner is entitled to it in the first instance, and allows the operator to keep it;
- it is therefore collected by the operator as agent for the landowner, and then retained by the operator as consideration within the contract.

As HMRC have said that the receipt does not give rise to a repayment, anyone wishing to argue this line will need to go to the Tribunal.

R & C Brief 57/08

2.1.2 Local authorities (1)

Commentators are still not sure who will win in the *Isle of Wight* case when it returns to the High Court from the ECJ. There are three possibilities:

- the High Court may decide it has enough facts to make a final ruling based on the ECJ's guidance
- the High Court decides it does not have enough facts and passes the case back to the Tribunal to find new facts using the correct test as set out by the ECJ;
- the High Court decides that the guidance has not answered the questions originally referred and therefore makes a further referral to the ECJ.

The main problem in applying the ECJ's current judgment is that it requires competition to be considered nationally, when the subject-matter is a very local market-place. It seems to require a theoretical consideration of competition (which can certainly be done), but there is no real competition between parking services provided in different parts of the country. It is therefore not entirely clear how that test should be applied.

There is also some evidence that the VAT position does not affect, or does not significantly affect, the pricing policies of commercial operators or local authorities providing parking. If pricing is not affected, it is hard to argue that competition is distorted from the public's point of view. However, the recovery of VAT on costs by local authorities represents a distortion: the authorities could achieve a higher margin than commercial operators because both recover VAT on costs but the local authority would keep all of its receipts.

2.1.3 Local authorities (2)

The ECJ has given a ruling on a case referred by the Slovak Republic concerning the extent of the non-taxable status conferred by "acting as a public authority". The case appears to deal with a situation in which a public authority has sub-contracted some of its functions (in particular, the work of bailiffs).

Consistent with other decisions on exemptions, the ECJ has confirmed that the sub-contractor does not enjoy any special status as a result of acting for a public authority. If the bailiff is an independent economic operator, the supplies to the public authority are taxable.

ECJ (Case C-456/07): *Karol Mihal v Danovy úrad Košice V*

A similar point arises in an application by the Commission for an ECJ order that Spain is not fulfilling its obligations under the Directive in respect of the services of certain land registrars. Land registrars are professionals appointed by the Spanish State and charged by it with the management of the land registers. They work on their own account, are free to organise their work, select their own staff and collect the payments which constitute their income themselves. The Spanish courts have recently decided that they are acting as a public authority and are therefore outside the scope of VAT. The Commission disagrees with this interpretation and is seeking an order to overturn the Spanish approach.

ECJ (Case C-154/08): *Commission of the European Communities v Kingdom of Spain*

A more general problem exists in Irish legislation. There, public authorities are outside the scope of VAT unless there is a specific order to the contrary issued by the Minister for Finance. There is no equivalent of the Directive provision for taxation of activities that are entered into not as public authorities, activities listed in Annex I, and activities where non-taxation would lead to a significant distortion of competition. In effect, the status of public authorities is entirely at the discretion of the Minister. The Commission has applied to the ECJ for an order to force Ireland to apply the Directive.

ECJ (Case C-554/07): *Commission of the European Communities v Ireland*

2.1.4 Consideration or grant?

Bath and North East Somerset Council made substantial payments to a charitable trust company for organising the Bath International Music Festival. It claimed that the money was consideration for supplies of services, so it would be entitled to recover input tax in relation to the costs of organising the festival. HMRC ruled that the money constituted a grant which was outside the scope of VAT.

Under the Local Government Act 2000, local authorities have the power to "promote the social well-being of their area". Presumably, if this constituted a supply of services to the local authority, it would be able to recover the VAT charged to it because it was exercising this statutory power in arranging for the festival to take place.

The arrangements between the council and the trust dated back to the 1990s. The activities covered by the two disputed rulings were governed by agreements made between the council and the trust in 2000 and in 2006.

The Tribunal examined the agreements in detail and concluded that the trust made supplies for consideration. Although the amounts paid were "round sums" which did not cover more than a quarter of the costs of the trust, and were not allocated to specific parts of the festival, nevertheless the written contracts imposed certain obligations on the trust in respect of service levels. The cases of *Hillingdon Legal Resources Centre* and *Wolverhampton Citizens Advice Bureau* were distinguished and the case of *Edinburgh Leisure* was followed. The payments represented consideration for supplies of taxable services.

VAT Tribunal (20,840): *Bath Festivals Trust Ltd*

2.1.5 Barter

A school granted a lease over some sports fields to a partnership which operated a commercial sports centre. The school received a peppercorn rent and the right to use the facilities at certain times. The partnership later transferred its business to a company, which took an assignment of the lease and continued to make the facilities available to the school in accordance with the earlier agreement.

HMRC assessed the company for output tax on the basis that there was a barter transaction with the school: the company was providing taxable

facilities in return for an exempt licence to occupy land. The company appealed, contending either that there was no barter transaction at all, or that the valuation put on the barter by HMRC was excessive.

The partnership had rented the land from the school since 1988, but there was little evidence about the original arrangements between the parties. The current lease, which was entered into in 2002, provided that "*The tenant will permit the Landlord including their agents employees and members of Kings School Gloucester access to the facilities at the Premises on the terms and in the manner set out in the Seventh Schedule*". The Seventh Schedule provided that "*The Tenant grants the Landlord (which expression shall include their agents employees (but in respect of employees to no more than 30 in any one year) and members of Kings School Gloucester) rights to use the sports facilities at the Premises at no cost on the following terms (or such other terms as shall be agreed or substituted between the Landlord and the Tenant (acting reasonably)*". The terms included the offer of discounts on membership to the school's employees and pupils who wanted to use the facilities independently.

The appellants argued that these clauses represented something reserved to the landlord (or "carved out") as part of the creation of the lease. The Tribunal agreed with HMRC that the proper analysis was to regard them as consideration for the grant of the lease. The lease represented an interest in the whole of the premises without anything being reserved back to the landlord.

It was relevant in deciding this that the school appeared to have the legal right to the whole building when the lease expired in 2002, so to grant a lease at a peppercorn rental to someone who could then run a commercial leisure centre and make profits of £250,000 a year would be an illogical thing to do.

The Tribunal then commented on the basis on which the consideration should be valued. The chairman agreed with HMRC that the way to approach the question was to consider the price that the school would otherwise have had to pay for using the facilities, as in the case of *Westmorland Motorway Services Ltd*; but he considered that the comparable prices would be the discounted rates for a corporate membership, rather than the normal rates payable by members of the public.

The value was not the ground rent that the school could have charged to the company. Although it was likely that the two figures ought to be comparable, the authorities show that where there are prices for the services which are charged to third parties, those prices are the basis for an "agreed valuation" for the supply of barter.

VAT Tribunal (20,848): *Riverside Sports & Leisure Ltd*

2.2 Disbursements

Nothing to report.

2.3 Exemptions

2.3.1 Insurance intermediary

A bank formed a subsidiary company (POFS) to provide insurance products to customers of the Post Office. POFS was owned just over 50% by the bank, the remainder of the shares being held by the Post Office. Neither the bank nor POFS was an authorised insurer, so it entered into an arrangement with an unrelated company (J) which in turn arranged for a panel of insurers to offer quotations to the customers referred by the bank.

The bank paid commission to the Post Office for introducing customers, and J paid commission to the bank. Presumably the insurers paid commission to J. It was accepted that these commissions were exempt within Sch.9 Group 2 Item 4 VATA 1994.

The arrangements were then changed to improve profitability. A single insurer, N, was selected to be the prime supplier; the panel of insurers had the opportunity to undercut N. N paid commissions to the bank, and HMRC ruled that these commissions were no longer covered by the exemption. Their argument was that the provision of an advantage over the other insurers went beyond the provision of an intermediary service, and was therefore fundamentally different from the accepted exempt supplies.

The Tribunal examined the various agreements carefully and also the relationship between them. It held that the new contract with N was fundamentally the same as the previous contract with J; the purpose of it was to enable the structure to continue with modifications, and it was not fundamentally different as HMRC contended. The commissions were exempt.

VAT Tribunal (20,824): *The Governor & Company of the Bank of Ireland*

2.3.2 Not insurance intermediary

The sale of Prudential's general insurance business to Winterthur Swiss in early 2002 was the subject of an important Tribunal decision (19,411) on place of supply of services in relation to the sale of a business. Now another aspect of the deal has been considered by the Tribunal.

The business was originally sold by P to W in a complex series of agreements. A month later, W novated its rights under the agreements in favour of a Bermudan subsidiary. In 2003 this company novated its rights again, this time in favour of a subsidiary of RBS. P was still running the business as agent but paying over the income to W, then the Bermudan company, and then RBS, in respect of their entitlements under the agreements. The beneficial owner then paid P commission, mainly in respect of renewal premiums for existing business.

HMRC ruled that this renewal commission was not exempt but standard rated. RBS appealed, but the Tribunal agreed with HMRC. P were not

acting as an insurance broker or agent with respect to RBS, because they were not putting the parties to the insurance contract in contact with one another, nor were they carrying out work preparatory to the conclusion of the contract (which already existed).

It is a curious result for a curious reason: P could not be an insurance agent or broker because they were the insurer (previously); they were being paid for the use of their brand name (to the casual reader of the renewal notice, it would appear that P was still directly involved); that was much closer to marketing than it was to acting as an insurance broker or agent.

VAT Tribunal (20,856): *Royal Bank of Scotland Group plc*

2.3.3 Public postal services

A commercial provider applied for judicial review of the UK legislation, which limits the scope of the exemption to the Post Office company itself. It argued that this exemption may have made sense when the legislation was written, because there was a statutory monopoly at the time; but now that the market for postal services has been liberalised, it represents an unfair distortion of competition. The questions for reference are:

1. a) How is the expression "the public postal services" in Article 13A(1)(a) of the Sixth VAT Directive (Directive 77/388/EEC)1 (now Article 132(1)(a) of Directive 2006/1122) to be interpreted?

b) Is the interpretation of that expression affected by the fact that postal services in a Member State have been liberalised, there are no reserved services within the meaning of Council Directive 97/67/EC3, as amended, and there is one designated universal service provider that has been notified to the Commission pursuant to that Directive (such as Royal Mail in the United Kingdom)?

c) in the circumstances of the present case (which are as set out in b) above) does that expression include(i) only the sole designated universal services provider (such as Royal Mail in the United Kingdom) or (ii) also a private postal operator (such as TNT Post)?

2. In the circumstances of the present case, is Article 13A(1)(a) of the Sixth VAT Directive (now Article 132(1)(a) of Directive 2006/112) to be interpreted as requiring or permitting a Member State to exempt all postal services provided by "the public postal services"?

3. If Member States are required or permitted to exempt some, but not all, of the services provided by "the public postal services", by reference to which criteria are those services", by reference to which criteria are those services to be identified?

ECJ (reference) (Case C-357/07): *R (oao TNT Post UK Ltd) v HMRC*

2.3.4 More gambling

In the case of *United Utilities plc v C & E* (Case C-89/05), the ECJ held that there was no 6th Directive exemption for acting as a "gambling intermediary". A company that collected bets for a pools company could not be exempt under art.13B(f) 6th Directive.

Two Belgian companies supplying similar services argued that they should instead be exempt under art.13B(d)(3), because they were involved in "*transactions, including negotiation, concerning deposit accounts and payments*". The ECJ characterised the services as follows: "*acceptance by the agent of bets on behalf of the client, registration thereof, confirmation to the client, by presentation of the betting slip, that a bet was made, collection of funds, payment of winnings, sole assumption of liability as regards the client for management of the funds collected and for thefts and/or losses of money and receipt of remuneration in the form of commission from the client as remuneration for that activity*"; it ruled that the exemption in art.13B(d)(3) did not apply to such services.

ECJ (Case C-231/07): *Tiercé Ladbroke v Belgian State*; (Case C-232/07): *Derby SA v Belgian State*

2.3.5 Sports club affiliation fees

Payments made by individuals to eligible bodies in respect of sporting services are exempt from VAT. However, Customs did not believe that exemption extends to payments of affiliation fees by clubs to national associations. The club's affiliation fee was not associated closely enough with sporting supplies to an individual. The club was not a "person taking part in sport", and it could not (as the Tribunal held, on appeal) be treated as "transparent" (the true supply being made for the benefit of the individual club members).

The High Court did not believe that the clubs should be regarded as transparent, but referred questions to the ECJ to find out if "persons taking part in sport" could be taken to include corporations and unincorporated associations.

The ECJ has now ruled that:

"*Article 13A(1)(m) 6th Directive … is to be interpreted as meaning that, in the context of persons taking part in sport, it includes services supplied to corporate persons and to unincorporated associations, provided that – which it is for the national court to establish – those services are closely linked and essential to sport, that they are supplied by non-profit-making organisations and that their true beneficiaries are persons taking part in sport.*

The expression 'certain services closely linked to sport', in Article 13A(1)(m) 6th Directive does not allow the Member States to limit the exemption under that provision by reference to the recipients of the services in question."

It is not clear whether HMRC will concede the case on that basis, or whether the High Court will have to determine the issue which the ECJ says is its prerogative.

ECJ (Case 253/07): *Canterbury Hockey Club v HMRC (and related appeal)*

2.3.6 Chain of supply

A company supplied two coin-operated pool tables to a university students' union. It collected the gross cash from the machine and paid 70% of the takings to the union. It accounted for VAT on the full amount in the machines, then submitted a repayment claim on the basis that the supplies should have been exempt under Group 10 Sch.9 VATA 1994 (sporting supplies by an eligible body).

The company were responsible for maintaining the tables and emptying them. According to Notice 701/13 *Gaming Machines and Amusement Machines*, this meant that they were to be treated as making the supply and they would be liable for output tax on the whole of the takings. They would not be exempt because they were a commercial organisation, not an "eligible body".

The cashier of the students' union gave evidence to the Tribunal but produced no documents (such as a contract which might have made it clearer who was supplying what to whom) and was unable to clarify how the union dealt with the VAT. The Tribunal was asked not to consider the liability of the union's supplies, which is apparently the subject of a separate dispute.

The Tribunal considered the evidence and arguments, and held that this pointed to the conclusion that the company supplied the facilities for playing pool, not the union. The company had therefore correctly accounted for VAT on the whole of the cash income from the tables.

VAT Tribunal (20,838): *Amusement Solutions Ltd*

Presumably the separate argument is about what the union is supplying in return for its 70% share. That seems likely to be "the supply of space for placing the machines" rather than a sporting service, as the supply appears to be made to the appellant company in this case rather than to the individual students playing pool. Under the ECJ's decision in *Sinclair Collis*, that would be a taxable supply.

If the arrangements were established differently, it would be possible for the union to make exempt supplies for the 100%, and to pay 30% to the company as rent for the tables. This would substantially reduce the VAT cost of the operation, but it would require changes to contracts and working practices to demonstrate that it was what actually happened.

2.3.7 Trade association

A trade association claimed a repayment of VAT on its subscriptions going back to 1973 on the basis that it should always have been exempt within art.132(1)(l) Directive 2006/112/EC. This exempts "the supply of services and the supply of goods closely linked thereto to their members in their common interest in return for a subscription fixed in accordance with their rules by non-profit making organisations with aims of a political, trade-union, religious, patriotic, philosophical, philanthropic or civic nature, provided that this exemption is not likely to cause distortion of competition". HMRC refused the claim and the association appealed to the Tribunal.

The Tribunal considered the ECJ's judgment in *Institute of the Motor Industry*. There it was held that a body should qualify under this provision if its main aim was the representation of its members' interests. The

Tribunal then considered the objects of the association in detail and decided that they were too general to qualify: it was too similar to the IMI, which the ECJ clearly did not think was the sort of body which enjoyed the exemption.

VAT Tribunal (20,887): *Heating and Ventilating Contractors Association*

2.3.8 Online guidance

HMRC have published online guidance on determining the liability of the right of admission to qualifying cultural activities, as provided for in VAT Act 1994 Sch.9 Group 13. It focuses mainly on the eligible body status of cultural bodies supported by Local Authorities.

www.hmrc.gov.uk/manuals

2.3.9 The missing exemption

The Advocate-General has considered questions in relation to the exemption in art.13A(1)(f) which is missing from UK law but is transposed into Netherlands law:

"*Services supplied by independent groups of persons whose activities are exempt from or are not subject to value added tax, for the purpose of rendering their members the services directly necessary for the exercise of their activity, where these groups merely claim from their members exact reimbursement of their share of the joint expenses, provided that such exemption is not likely to produce distortion of competition.*"

The appellant in the appeal is a foundation which aims to promote quality in medical care, for example by upholding standards in the medical and nursing professions. Its members are exempt under the healthcare rules, so it would fall within the exemption in relation to services for which it is exactly reimbursed by its members in accordance with the above provision.

The issue in the case arose because it provided some services to individual members for specific payments which were not "exact reimbursement" of a "share of joint expenses". The Netherlands authorities ruled that such activities were not within the scope of the exemption, and questions were referred to the ECJ.

The Advocate-General observed that the question suggested that the costs were recharged to the recipients of the services at a figure no higher than the amount incurred by the entity: while this meant that the entity would not make any profit, it could have implications for distortion of competition if the recipients could receive the same supplies more cheaply than they would if they had to go to a commercial supplier recharging on a full cost basis.

On the other hand, it did not appear to be a problem that the supply was made to an individual member rather than jointly to all of them. The Advocate-General's opinion was that such activities could fall within the exemption provided that the other conditions – the recharging of the exact cost and the non-distortion of competition – were satisfied.

The ECJ upheld the foundation's position, ruling that the exemption applied to the services that it supplied to individual members. It appears that this was the main point of contention in the circumstances of the case,

and the Advocate-General's comments about charging below cost were not directly relevant to the outcome.

ECJ (Case C-407/07): *Stichting Centraal Begeleidingsorgaan voor de Intercollegiale Toetsing v Staatssecretaris van Financiën*

2.4 Zero-rating

2.4.1 Sports bar

A trader manufactured a high carbohydrate, low fat sports bar for seriously minded athletes. It argued that the bar was not "sweetened" because the main ingredients made it sweet, and it was not "confectionery". The Tribunal relied on the *Premier Foods* decision of the High Court to conclude that the first ground of appeal was misconceived – a product did not have to have sugar added to make it "sweetened".

The second ground was also ill-founded: confectionery is defined in the legislation ("any item of sweetened prepared food which is normally eaten with fingers"), so it was not possible to rely on a "generally understood" meaning of the word. The bar clearly fell within that definition and was standard rated.

VAT Tribunal (20,821): *H5 Ltd t/a High Five*

2.4.2 Transport?

The company which runs a Scottish ski area has previously lost an appeal in which it attempted to zero-rate the provision of "transport" in chair-lifts. It returned to the Tribunal to argue about a "magic carpet" which conveyed beginners up the beginners' slopes. It was clearly designed to carry more than 10 passengers at once.

The taxpayer's counsel argued for a broad-minded approach to the concept of "passenger transport". The Tribunal was more old-fashioned, finding it hard to consider the carpet to be a "vehicle" and noting, pedantically, that Group 8 Sch.8 refers to transport "in" a vehicle. The skiers were "on" the carpet, not "in" it. The appeal was dismissed.

VAT Tribunal (20,886): *The Lecht Ski Co Ltd*

2.5 Lower rate

2.5.1 Fuel for private craft

From 1 November 2008, when EU derogations allowing reduced rate duty on fuel in private pleasure craft expired, it is illegal for red diesel to be used for propelling private pleasure craft unless the purchaser of the fuel makes a declaration to that intent and pays the full rate of excise duty. Red diesel at the rebated rate of duty can continue to be used for domestic purposes such as heating and lighting.

R & C Brief 49/08; SI 2008/2599

By contrast, HMRC have issued a Brief to confirm that the lower rate of VAT will continue to apply to fuel oil, gas oil and kerosene used as fuel for propelling private pleasure craft and kerosene used as fuel for private pleasure flying after 31 October 2008, even though the derogations expired at that time. A new Statutory Instrument confirms the rules.

R & C Brief 52/08; SI 2008/2676

2.5.2 Online guidance

HMRC have published online guidance on energy-saving materials and grant-funded heating and security supplies. It covers the history of the reduced rate, energy-saving materials and grant-funded installations.

www.hmrc.gov.uk/manuals

2.6 Computational matters

2.6.1 Change of rate

This section reviews the rules which are relevant to the change of standard rate of VAT which was announced on 24 November 2008 to have effect on 1 December 2008. There will be another change back from 15% to 17.5% on 1 January 2010. The same rules will apply then, but different practical considerations may be relevant where the rate is rising – so customers will want the tax point to be advanced before the change of rate – to the immediate situation where the rate is falling, so customers will want the benefit of the new rate.

There is a range of guidance, including FAQs, summary and detailed notes, available on the HMRC website. All registered traders were sent the summary guidance in the post on 24 November.

www.hmrc.gov.uk/pbr2008/measure1.htm; SI 2008/3020

2.6.1.1 Outline of the problems

The basic technical issues are these:

- what rate of VAT should I charge to my customers on sales?
- what rate of VAT should I deduct as input tax?

The starting point lies in the tax point rules:

- if the tax point for a supply fell up to 30 November 2008, the supplier should charge 17.5% and the customer should deduct that as input tax;
- if the tax point for a supply falls on or after 1 December 2008, the supplier should charge 15% and the customer can deduct no more than that as input tax.

There are some special rules which allow traders to charge the new rate if they want to, even though the normal tax point rules appear to put the supply in November. These are described below after the "normal" tax point rules.

There are also major practical problems involved in a change of rate, in particular:

- for retailers, repricing everything in the shop between close of business on 30 November and opening on 1 December – or deciding some other practical way of dealing with the rate change, such as offering discounts at the till regardless of what is shown on the ticket;
- for retailers, making sure that electronic tills are adjusted to use the new rate at the right time;
- for retailers, dealing with extra complications on retail scheme calculations (beyond the scope of this lecture – described in the HMRC detailed guidance);
- for everyone, correcting errors that are likely to arise;
- for everyone, the possibility that paperwork issued in December should still properly use the old VAT rate because it relates to something that happened before the change of rate – this may be

difficult to spot, and it may also be difficult to achieve if the computer believes that there can only be one standard rate of VAT at a time.

2.6.1.2 Tax point rules

There is a basic tax point when the supplier provides the purchaser with the subject matter of the supply. In short, this is:

- for goods, when the goods are "removed" from the supplier to the purchaser (s.6(2) VATA 1994);
- for services, when the services are "performed" (normally meaning "completed") (s.6(3)).

The basic tax point is overridden by:

- issue of a tax invoice or receipt of payment, which will advance the tax point if it falls before the basic tax point (s6(4));
- issue of a tax invoice, if this takes place in the period up to 14 days after the basic tax point (s6(5)).

The "14 day rule" can be waived by the taxpayer (i.e. it is permissible to apply the basic tax point rule even if a tax invoice is issued a few days later), or extended by application to Customs (e.g. where the trader sends out all invoices at the end of the month).

Note that receipt of payment is only relevant if it occurs before the basic tax point, whereas the raising of a tax invoice can affect the tax point if it is before or after the basic date. There are other rules in s.6 to cover a number of special situations, for example "sale or return" in s.6(2)(c) and s.6(4).

Note that the tax invoice is required to show not only the date of the issue of the invoice but also the time of the supply. These may be the same (because the invoice may trigger the tax point) but they do not have to be.

It is possible to have more than one tax point for the same supply – for example, if a deposit is received for a sale, and the balance is paid on the date of delivery, and a tax invoice is issued three days later, the rules above provide that:

- the tax point for the deposit is the date it is paid;
- the tax point for the balance is the date the invoice is issued.

Where services are supplied "continuously", they are never finally "performed". There is therefore no basic tax point, and payment or invoice have to be used instead. SI 1995/2518 reg.90 provides that a single invoice can be issued in advance for a period of up to a year, specifying periodic payment dates, and these are used for the tax point of each period payment – not the date of the invoice itself. Continuous supplies of services include rent, most subscription supplies, and some consultancy agreements, and are defined as any situation where supplies are made over a period for a periodic payment (e.g. monthly/quarterly) rather than specific payments being made for specific supplies.

Where supplies are deemed to be made under the reverse charge rules, the tax point is only determined by the date the services are paid for – the time they are actually performed, and the date of an invoice, have no effect (reg.82).

2.6.1.3 *Special rules on a change of rate*

The special rules on a change of rate are in s.88 VATA 1994. These provide that:

- the rate ruling on the tax point date is the starting point;
- if the basic tax point (delivery/completion) falls one side of the rate change but the special rules in s.6 have shifted the time of supply to the other side, the supplier can choose to charge VAT at the rate ruling on the basic tax point instead.

As traders are likely to want to prefer to charge VAT at 15% rather than 17.5%, the rule is likely to be applied as follows:

Basic tax point	s.6 "shifted" tax point	s.88 choice?
November 2008	December (invoice in 14 days)	No – charge 15%
December 2008	November (payment/invoice in advance)	Yes – charge 15%
December 2009	January 2010 (invoice in 14 days)	Yes – charge 15%
January 2010	December 2009 (payment/invoice in advance)	No – charge 15%

We are warned that there are likely to be anti-avoidance measures to stop traders fixing tax points artificially before the rate rises again in January 2010. Details have not yet been given.

s.88 does not appear to affect the actual tax point (i.e. the time at which the supplier must put an entry in the VAT account) – only the rate at which the supply is charged. So if s.88 applies, VAT at 15% can appear in a VAT return to 30 November.

Continuous supplies

The HMRC guidance points out a distinction between a continuous supply of services and a single supply in applying s.88. In both cases, the starting point is the basic tax point; for a continuous supply, that can only be the invoice or the payment. A trader is likely to want to use s.88 for supplies which have been paid for or invoiced in advance:

- if it is a continuous supply, s.88 will apply by apportioning the affected amount on a reasonable basis to the period up to 30 November and the period afterwards;
- if it is a single supply, there will be no apportionment – even if the supplier has done some of the work before 1 December, the 15% rate can be applied to the whole amount.

The guidance gives the example of rent as a continuous supply: if a landlord has received £10,000 + £1,750 in VAT in advance for the 3 months to December 2008, it will be possible to issue a credit note for 1/3 x £250 to reduce the VAT rate applicable to December to 15%.

The contrasting example is a solicitor preparing a will. That is a "single" service, even though some of the work may have been done in December. A single VAT rate will apply.

It is not always easy to tell what is continuous and what is single. Accountancy services provided to regular clients are often regarded as continuous supplies, but one-off consultancy services are generally not. Construction services are subject to special rules in reg.93 SI 1995/2518, and they are likely to be treated as continuous services where regular stage payments are made. That means that payments up to 30 November will probably be charged at 17.5% without the option of reducing them later. However, the guidance does recognise that a construction service can be a "single payment contract", in which case s.88 could be applied to the whole price and an apportionment would not be required.

A continuous supply of services can be the subject of a special "scheduled" VAT invoice, which specifies the amounts payable and the due dates for up to a year in advance. The scheduled dates, rather than the issue of the invoice itself, trigger tax points. Where such a document has been issued before 24 November covering periods later than 1 December, the rates will be wrong and the document will have to be reissued.

Adjusting prices

Where the trader exercises the choice under s.88 and as a result reduces the VAT from 17.5% to 15%, it will be necessary to issue a credit note to the customer (and a refund, if payment has already been received).

17.5% still used in December

It will be necessary to use the 17.5% rate after 30 November in the following circumstances:

- invoice issued more than 14 days after a supply that happened up to 30 November, so the tax point is not shifted (but see note below);
- credit note relating to returns or price adjustments on supplies with tax points up to 30 November – the rate on the original supply must be used for any adjustments to it.

Further extension of credit notes

S.88 provides that correcting credit notes have to be issued within 14 days of the original supply in order to reflect the "election" to use the VAT rate after the change. This has been amended to 45 days to allow for those who would find the limit hard to meet (see below).

SI 2008/3021

2.6.1.4 HMRC summary

HMRC's guidance to traders is intended to clarify which rate they should charge. Issued on 28 November 2008, it may confuse more than it helps: the whole text is reproduced below for a full picture of the assistance that HMRC have provided to taxpayers.

THIS SUPPLEMENT EXPLAINS HOW TO DETERMINE THE VAT TREATMENT FOR SALES THAT SPAN 1 DECEMBER 2008

Supply of Goods

Earlier of payment made or invoice issued	*Before 1/12/08* ***17.5%*** *but you can choose to charge **15%** if the goods are to be delivered on or after 1 December 2008.*	*On or after 1/12/08* ***15%*** *but you should charge **17.5%** if:* *• goods have been delivered before 1st December and the invoice was issued more than 14 days* after the delivery date; or* *• The invoice is for a payment received before 1 December 2008 (although you can choose to charge **15%** if the goods are to be delivered on or after 1 December 2008).*

Supply of Individual Services

This relates to services where the work is in the nature of a "one off" e.g. repairing a car, decorating a room etc rather than a continuous supply (see below).

Earlier of payment made or invoice issued	*Before 1/12/08* ***17.5%*** *but you can choose to charge **15%** if the services are to be completed on or after 1 December 2008.*	*On or after 1/12/08* ***15%*** *but you should charge **17.5%** if:* *• Services have been completed before 1st December and the invoice was issued more than 14 days* after the services were delivered; or* *• The invoice is for a payment received before 1 December 2008 (although you can choose to charge **15%** if the services are to be completed on or after 1 December 2008).*

HMRC has by concession extended the period for all businesses to 30 days for supplies made between 18th – 30th November (see What's New for further details). You do not need to contact HMRC to use this concession.

Supply of Continuous Services

If you supply services that are consumed over a period of time and your contract requires your customer to pay you from time to time it is likely that you are making a continuous supply of services. Examples are a contract for ongoing office cleaning, telephone, broadcasting, leasing of equipment, etc. The rules below apply:

Earlier of payment made or invoice issued	*Before 1/12/08* ***17.5%*** *But you can choose to charge 15% for* ***that part of the supply*** *(covered by the payment or invoice) made on or after 1 December 2008.*	*On or after 1/12/08* ***15%***

Supply of Construction Services

Where you make supplies (including design, advisory and supervisory services) under a construction contract, which involves your customer making stage payments.

Earlier of payment made or invoice issued	*Before 1/12/08* ***17.5%*** *but you can choose to charge 15% for* ***that part of the work performed*** *(covered by the payment or invoice) on or after 1 December 2008.*	*On or after 1/12/08* ***15%***

http://www.hmrc.gov.uk/pbr2008/treatment-sales.pdf

2.6.1.5 Mistakes

The guidance accepts that this is a big change and it is likely that traders will make mistakes. We are promised "policing with a light touch". The main errors that are likely to occur are:

Traders getting the basic cut-off wrong – still charging 17.5% in December. This is mainly a problem for the customer, who is not allowed to deduct more than 3/23 of the gross amount where the time of supply properly falls after the change. The customer should insist on a credit note.

Traders getting the tax point rules wrong – accounting for 15% in December even though the appropriate rate remains 17.5%. Such errors need to be corrected, but HMRC are supposed to help rather than penalise.

Particular issues may arise in relation to cash accounting and the flat rate scheme, where the delay in accounting for VAT on receipts and payments may lead traders to apply the wrong rate. The guidance emphasises that it is the date of the supply that fixes the amount of VAT, and cash accounting does not change that: cash accounting traders, and FRS traders

who use receipts under that scheme, must identify their receipts and account for the correct amount of VAT on them according to when the original supply was made.

2.6.1.6 Further guidance

Further guidance was issued on 1 December in response to questions asked following the Pre-Budget Report. The points made in this additional guidance were as follows.

Electronic Cash Registers

1. I cannot update my electronic cash register or till with the new VAT rate on 1 December.

We acknowledge that some retailers may be unable to adjust their electronic cash registers or tills and there may be instances where either a VAT rate of

17.5% or an incorrect VAT amount will be shown on till receipts after 1st December even though the gross price may have been reduced. In order to achieve a pragmatic solution we will exceptionally allow retailers to account for VAT at the correct rate of 15% (3/23) where appropriate even if the till receipt is incorrect. We would however expect retailers to be producing correct till receipts as soon as possible.

Businesses that have made purchases from a retail shop after 1st December should only recover 3/23 of the gross amount on those items on which they are entitled to recover VAT.

VAT Invoices

Extension to the normal Time Limit for Raising VAT Invoices

Summary

HMRC has by concession extended the period of 14 days referred to in the table below, to 30 days, for supplies made between 18th and 30th November 2008.

If you are a business that sells mainly to other VAT-registered businesses and have to issue VAT invoices

You should use the new rate for all VAT invoices that you issue on or after 1 December 2008 ... ... except for where

-- you provided goods or services more than 14 days before you issue the VAT invoice. For example, if you issue a VAT invoice on 1 December for goods or services provided before 18 November 2008, or

-- you were paid before 1 December.

In these cases, your sale took place before 1 December and you must use the old rate of 17.5%.

Detail

VAT becomes due on the supply of goods and services when the "tax point" occurs. The table below explains the basic tax point:-

Basic tax points

If you supply... Then the basic tax point is...

goods usually the date when you send them to your customer or the customer takes them away. This includes supplies under hire-purchase, credit sale or conditional sale agreements.

goods but they are not to be sent or taken away (for example because you put them together on your customer's premises) the date you make them available for your customer to use.

services the date when the service is performed (normally taken as the date when all the work except invoicing is completed).

However, VAT legislation provides that where a VAT invoice is issued up to 14 days after the basic tax point the date of the issue of the invoice becomes the actual tax point.

The VAT legislation also permits HMRC to agree an extension to the 14 day limit if a business applies to use a longer period.

HMRC has been approached by a number of trade sector bodies asking for a temporary extension of the 14 day limit that could be used by any business without requiring HMRC's formal approval. This will allow businesses additional time to amend their accounting systems following the rate change.

HMRC has agreed that the normal 14 day limit can be extended to 30 days. This general approval applies to all businesses where the goods or services to be invoiced were provided between 18 November 2008 and 30 November 2008, inclusive.

Businesses that have previously agreed an extension to the 14 day limit with HMRC can continue to use that time limit but where it is less than 30 days they can opt to use the 30 day limit.

Credit Notes and the change in the standard rate

1. Can credit notes be issued to cancel supplies of services completed and invoiced before 1 December 2008 when the rate of VAT was 17.5%, with new invoices issued on or after 1 December showing VAT of 15%?

Response

No. Where services have been completed and invoiced before the rate change, the 17.5% rate applies.

2. Does HMRC insist that businesses have to make a cash refund to their customers to be able to credit VAT?

No. It is not necessary to make a refund by cash, cheque or bank transfer (for example) provided that the credit note you issue actually gives value to your customer. In many cases all that will be required is to credit your customer's account instead.

For example, a trade association charges its members an annual fee. The membership year runs from 1 April to 31 March, fees are payable in advance and VAT invoices issued. For the year ending 31 March 2009 eight months of the fee will carry VAT at 17.5% and the remaining four will carry VAT at 15%. The association issues credit notes to its members to take account of the reduction in the standard rate from 1 December 2008. However, it does not refund the money but, instead, holds the amounts as credits against next year's subscription.

This is acceptable because the members have received the value of the credit.

Guarantees for Import VAT

1. Will my Guarantee for Import VAT go down as a result of the VAT rate change?

Guarantees for Import VAT that have been secured before the 1st December will be charged at 17.5%, but thereafter all guarantees for Import VAT will be based on the new rate of 15%.

Businesses that have an existing Guarantee to cover import VAT can request a lower guarantee amount to take account of the potentially lower liability as a result of the VAT rate reduction. However, this may involve additional costs and businesses may prefer to maintain the current level of their Guarantee.

2.6.2 Anti-forestalling legislation

The Government announced an outline of anti-avoidance legislation to apply from 25 November 2008 but to be detailed in the Finance Act 2009. The general idea is to prevent traders fixing a tax point for a supply at 15% when "really" the supply takes place after 31 December 2009. The ministerial statement announcing this included the following:

Anti-forestalling legislation will apply from today to ensure that, in the circumstances set out below, supplies with a basic time of supply after a VAT rate increase takes effect will be subject to the rate of VAT in force at that time. The provisions are designed to prevent artificial forestalling whilst being straightforward for business to understand and operate and not affecting genuine commercial transactions. This legislation is not intended to catch the normal commercial activity of providing goods and services.

The anti-forestalling legislation will apply in the circumstances set out below where the supplier receives a prepayment for the goods or services or issues a VAT invoice in advance of the rate increase. It will also apply where, in advance of the rate increase, the supplier grants the customer an option or a right to obtain goods or services at a discount or free of charge after the rate increase takes effect.

The circumstances are that the customer cannot recover VAT in full on the supply and that:

- *the supplier and customer are connected parties; or*
- *the supplier receives a prepayment, or grants the customer an option or a right, and the prepayment, or the acquisition of the option or right, is wholly or partly funded (directly or indirectly) by the supplier; or*
- *a VAT invoice is issued by the supplier showing an amount any part of which is due more than 6 months after the date of the invoice.*

The basic time of supply is normally when goods are delivered or made available, or when services are performed. For continuous supplies of goods or services, with consideration payable periodically or from time to time, the basic time of supply will be the end of the period to which a payment or invoice relates (e.g. a billing period).

Although the anti-forestalling legislation will apply from today, any extra VAT arising from its operation will not become due until after Royal Assent of Finance Bill 2009. Until then, suppliers should continue to account for VAT as normal, applying the VAT rate at the time of the prepayment, VAT invoice issue or grant of the right or option.

The operation of the legislation will be kept under review to ensure that the provisions work as intended. Any additional or alternative anti-forestalling provisions included in Finance Bill 2009 will only take effect at the earliest from the date that they are announced.

Ministerial statement 25 November 2008

2.6.3 Reaction to the rate change

Not surprisingly, reaction to the rate change has been mixed. The Chancellor said that it represented a £12.5 billion tax cut which would be targeted on consumer spending and would help to stimulate the economy. This is welcomed by a varied group which includes ICAS, ICAEW, CIOT, CBI, ABI, ACCA and BCC, but they also point out the administrative burdens created for business and the complexity of the tax system, which may outweigh any advantage for consumers.

There is an article by Neil Warren reviewing the change in *Taxation*, 4 December 2008.

2.6.4 VAT and SDLT

Stamp Duty Land Tax is calculated on the gross consideration for the chargeable transaction in property. This is the VAT-inclusive amount where VAT is or could be applicable. On the grant of a commercial lease, the SDLT depends on the net present value of future rents, calculated in accordance with a statutory formula.

The change in VAT rate means that the gross amount of VATable rent due between 1 December 2008 and 31 December 2009 will be lower. HMRC will accept reclaims in respect of NPV calculations where the rent was not ascertainable for the first five years of the lease, and this reclaim will be available for the VAT reduction. HMRC estimate that the repayment will be no more than £250 for a £1m annual rent.

If the fifth year of the lease ends before 31 December 2009, any claim for repayment of overpaid tax should be made within thirty days of the date when the rents for the first five years of the term become certain. Interest will be paid on repayments on the usual basis.

HMRC Press Release 3 December 2008

2.6.5 Retail schemes

The threshold above which businesses are required to agree a bespoke retail scheme with HMRC is to increase from £100 million to £130 million with effect from 1 April 2009. Bespoke schemes agreed by retailers whose annual turnover is between £100 million and £130 million will continue in operation until or unless the agreement ends.

The PBR Notice does not explain how many retailers will be affected by this – it seems unlikely that there are a very large number with turnover of more than £100 million but less than £130 million who would find it easier to operate a "standard" scheme than a bespoke one that they have already agreed.

PBRN 24

There is an article by Neil Warren reviewing retail schemes in *Taxation*, 20 November 2008.

2.6.6 Rounding

A chain of public houses operated a policy of "rounding down" its VAT calculations. HMRC issued a ruling that it was required to round mathematically, in line with the Tribunal's decision in *Topps Tiles plc* (19,751). The case has now been referred to the ECJ, where the Advocate-General has given the following opinion:

"*In the absence of specific Community legislation, it is for Member States to decide on the rules and methods of rounding amounts of VAT, provided that in doing so they observe the principles underpinning the common system of VAT, in particular those of fiscal neutrality and proportionality. Community law neither precludes Member States from requiring taxable persons to round the amount of VAT arithmetically in all cases nor requires them to permit such persons to round the amount down in all cases. Where sales are made at VAT-inclusive unit prices in round figures and the amount of VAT includes a fraction of the smallest available unit of currency, Community law does not require that amount to be rounded to a whole unit before the stage at which it must be expressed as a figure which does not include such a fraction, in particular in order to render it capable of payment as an independent sum. If traders making supplies based on VAT-exclusive unit prices in round figures, to which VAT must be added, are allowed to round the amount of VAT downwards on each invoice, the principles of equal treatment and fiscal neutrality do not preclude requiring traders who make supplies based on VAT-inclusive unit prices in round figures, from which the VAT component must be calculated, to round the amount of VAT arithmetically.*"

This appears to be consistent with the recent decision of the full court in the *Ahold* case.

ECJ (A-G) (Case C-302/07): *JD Wetherspoon plc v HMRC*

2.6.7 Private use

An question has been referred to the ECJ by the Netherlands Supreme Court. The court wants to clarify the treatment of goods and services purchased for part private, part business use, and to understand better the self-supply charges that may arise over the ownership of an enduring asset:

Are Articles 6(2) and 17(1), (2) and (6) of the Sixth VAT Directive to be interpreted as permitting a taxable person to allocate wholly to his business not only capital goods but all goods and services used both for business purposes and for purposes other than business purposes and to deduct immediately and in full the VAT due on the acquisition of those goods and services?

If the answer to Question 1 is affirmative, does the application of Article 6(2) of the Sixth Directive to services and goods other than capital goods mean that VAT is collected once during the tax period over which the deduction in respect of those services and goods is enjoyed, or must collection also occur in ensuing periods and, if so, how is the taxable amount to be determined in respect of goods and services which the taxable person does not write off?

ECJ (reference) (Case C-515/07): *Vereniging Noordelijke Land- en Tuinbouw Organisatie v Staatssecretaris van Financiën*

2.7 Discounts, rebates and gifts

2.7.1 Free lunches

The Danish court referred questions to the ECJ about the situation where commercial companies provided meals without charge to clients visiting their premises and to employees involved in business meetings.

The Advocate-General gave an opinion that such meals could be chargeable as deemed supplies under art.5(6) or art.6(2) 6th Directive (old numbering), but only where they served "principally purposes other than those of the business". If the purpose of providing the meals was to enhance the efficiency of meetings in which the recipients are participating, they are not covered by the deemed supply rules. Similarly, if employees are required to attend meetings and are therefore effectively required to eat the refreshments made available rather than making their own choices about consumption, there would be no deemed supply.

The Advocate-General also commented that an output tax charge under these provisions is in any case only possible if an input tax deduction is available for some or all of the costs.

The Danish law excludes input tax deduction for such costs. However, the Advocate-General's opinion is that this exclusion is not permitted. It would only be allowed under the transitional provisions for exclusions that a member state had in its law when the 6th Directive was implemented; in Denmark staff canteens were not subject to VAT before the Directive was implemented in 1978, and the exclusion was only provided for by an administrative practice which continued to regard such costs as non-business. The Advocate-General held that this did not fall within the

definition of a rule being "retained". It would have to be within the law itself.

The ECJ has now confirmed the opinion on both aspects of the rules. Input tax can be claimed without any deemed supply liable to output tax where there is a business purpose, and input tax cannot be blocked unless a legal block was in place when the 6th Directive came into force in Denmark.

ECJ (Case C-371/07): *Danfoss A/S and AstraZeneca A/S v Skatteministeriet*

The UK regards meals provided for employees "in the course of catering" as eligible for input tax deduction and only chargeable to output tax on any amounts actually paid by the employee. It is not clear whether refreshments bought in would be properly regarded as within the scope of Sch.6 para.10 VATA 1994, but it seems likely that input tax is generally deducted for such refreshments without an output tax charge.

The provision of such refreshments for someone who is not an employee would fall within the "business entertainment" rules in SI 1995/1268, and input tax would be blocked. This blocking is probably protected by the transitional rules, even if the Advocate-General's opinion suggests that there is a business purpose for the meals provided to the third parties.

2.8 Compound and multiple

2.8.1 Cleaning and rent

A Czech residential landlord invoiced tenants separately for rent and the cleaning of the common areas of the building. The landlord believed that the whole supply was indivisible and should all be exempt. The authorities ruled that the two supplies were separate and the cleaning services were VATable.

The Advocate-General has given an opinion supporting the authorities:

1. Articles 6 and 13 of the Sixth Directive must be interpreted as meaning that residential tenancy (or, possibly, tenancy of spaces which are used for purposes other than those for dwelling), on one hand, and the cleaning of common areas which is associated, on the other hand, is to be regarded as autonomous and separable activities.

It is a matter of national courts to determine whether the provisions of the tenancy agreement, the rules of procedure of the building and the legal practice in effect in the state concerned exceptionally allow a different interpretation.

2. In situations where the national court held that the tenancy and the associated cleaning of common areas can not exceptionally be regarded as autonomous and separate operations, the cleaning of common areas must be regarded as a part of "letting of immovable property" under art. 13B(b) of the Sixth Directive and the amount paid in relation to that activity is exempt from VAT.

ECJ (A-G) (Case C-572/07): *RLRE Tellmer Property s.r.o. v Finanční ředitelství v Ústí nad Labem*

2.9 Agency

2.9.1 Client account

A company appeared to have set up its whole business structure based on VAT advice. As the Tribunal confirmed assessments for more than £1.2m covering the periods July 2002 to November 2004, this advice appears to have been flawed.

It was common ground that a company which supplies "loft conversion services" to a customer must charge VAT on the whole of what the customer pays, when the customer pays it. The companies in this case argued that they provided "project management services". They received money from the customer and put it in a client account. It would then be taken out of the client account:

- to pay the project manager's fees, which were included in the companies' VAT returns, company accounts and corporation tax computations;
- to pay the costs of the project, which were regarded as disbursements of the client's money and therefore not part of the companies' accounts at all.

At the end of a project, some money was retained within the client account to cover the possible cost of claims under a ten-year guarantee. That part of the client's payment would not be subject to VAT until much later when it was released to the project manager.

The company director claimed that the company's contracts reflected the intended arrangements. The company arranged contracts between the various suppliers – designers, plumbers, electricians, plasterers, and so on – and the clients. The contracts should determine the nature of the supply unless they were a sham, which they were not.

The Tribunal took evidence from a number of witnesses, including a client and some tradesmen. Although the fine print attempted to create the contracts that the director contended for, it seemed unlikely that anyone else understood that to be the case. In particular, the client – who was a friend of the director and presumably was trying to support his case – did not believe that he had a contract with each of the individual tradesmen. If there had been a problem, he would have expected the company to put it right.

As a result, the company was supplying the loft conversion service itself, and it was liable to output tax on all its receipts. It is perhaps surprising that there was no mention of a misdeclaration penalty in the case, because the numbers are so large that it would appear inevitable that s.63 would be in point.

VAT Tribunal (20,888): *A1 Lofts Ltd & A1 Loft Conversions Ltd*

2.10 Second hand goods

2.10.1 Failure to keep records

A trader sold second hand cars. HMRC assessed for output tax on the full selling prices of the cars on the basis that the trader had not complied with the requirements of the second hand scheme – the detailed records to prove the margins were not maintained. The trader produced reconstructed records, but HMRC did not accept them. The trader appealed against an assessment for £73,384, which was reduced to £72,508 at the hearing.

The Tribunal examined the background to the dispute in detail. It appeared that the trader had made considerable efforts to reconstruct the records, but that these efforts did not satisfy HMRC. The chairman noted that the refusal to accept reconstructed records was not within s.83 VATA 1994, but was within the extended jurisdiction of the Tribunal under s.84(10): "*Where an appeal is against a decision of the Commissioners which depended upon a prior decision taken by them in relation to the appellant, the fact that the prior decision is not within section 83 shall not prevent the tribunal from allowing the appeal on the ground that it would have allowed an appeal against the prior decision.*"

The Tribunal concluded that the reconstruction was the best possible reconstruction that the accountant could produce from the information and records available, but even she did not claim it was 100% accurate because the records were in any case unsatisfactory. The Tribunal held that HMRC's refusal to accept the original records, and the refusal to accept the reconstructed records, were both "not unreasonable" prior decisions on which the assessment to output tax depended. The appeal was therefore dismissed.

VAT Tribunal (20,858): *Alan Thornhill t/a Motormill*

2.11 Charities and clubs

Nothing to report.

2.12 Other supply problems

2.12.1 Fuel scale rates

The cut in the VAT standard rate affects the scale rate output tax on fuel for private use. New figures apply for periods from 1 December 2008 to 31 December 2009. The revised scales are set out in Annex D of the detailed guidance note on the rate change.

www.hmrc.gov.uk/pbr2008/measure1.htm

3. LAND AND PROPERTY

3.1 Exemption

3.1.1 Hairdressers

Two appeals by hairdressers' salons have been heard by the High Court. In both cases, the Tribunal had examined the facts and decided that the salons were making single supplies of taxable facilities to the hairdressers who worked there, rather than separate supplies of taxable facilities and an exempt licence to occupy land. The terms of the agreements between the taxpayers and their "licensees" was slightly different between the two cases, but the decisions were the same.

The High Court dismissed both appeals. The Tribunal had plenty of evidence to justify a decision that there was a single indivisible supply that it would be artificial to split. The various facilities were closely interdependent in that the provision of one (for example the chair) was of little or no practical utility without the provision of the others. All were supplied pursuant to a single agreement.

Furthermore, the fundamental nature of the supply was facilities, not mere occupation of land. The judge commented that the exemption under Sch.9 Group 1 Item 1 did not "*extend to a licence to occupy land which is but one element of a package of supplies made by the taxpayer/lessor to his customer in consideration of a payment or payments by that customer where the supplies in question are commercial in nature or are best understood as the provision of a service and not simply as the making available of property*".

High Court: *Holland (trading as The Studio Hair Company) v HMRC; Vigdor Ltd v HMRC*

3.2 Option to tax

3.2.1 Disapplication and time limits

HMRC raised an assessment in relation to the disapplication of the option to tax. The issues in dispute were the time limits for raising assessments rather than the technical issue of the disapplication itself:

	Appellant	HMRC
Assessment raised	26 Feb 2007	2 Feb 2007
Facts known	9 May/2 Nov 2005	23 Oct 2006

Clearly, on the appellant's interpretation the assessment for the periods 02/04 to 11/04 were out of time; on HMRC's, the limit of "one year after evidence of facts, sufficient in the opinion of the Commissioners to justify the making of the assessment, comes to their knowledge" in s.73(6) VATA 1994 would apply.

The company purchased a property for £310,000 plus VAT on 20 January 2004. It had sent an option to tax to HMRC in June 2003; this was acknowledged by HMRC on 10 December 2003. On 27 January 2004 the

company granted a 20-year lease to Mr and Mrs Patel, its own controlling shareholders, for them to run a nursery business in. Further renovation and conversion expenditure was incurred by the company during 2004; in February 2005 the Patels occupied the property for the nursery business.

On 8 February 2005 a Customs officer examined the company's records and concluded that the anti-avoidance provisions in Sch.10 para.2(3AA) VATA 1994 applied. This was communicated to the company on 9 May 2005 in the form of a written decision. The decision explained that reclassification of the lease as exempt would mean that the company should be deregistered from the outset (because it had no other intended taxable supplies) and would have to repay all the input tax it had claimed.

The company asked for reconsideration of the decision. Its accountants wrote to HMRC in June 2005 pointing out that the company was in occupation of part of the premises for its own taxable purposes, and the decision to deregister the company and claw back all the input tax was therefore wrong.

In further correspondence, it was pointed out that a City Council SureStart nursery was due to open next door, which would make the proposed nursery of the Patels unviable. As a result, the company would have to do something else with the property. The reviewing officer said that this might make a registration valid from a current date, but not from the date originally applied for – the intention at that earlier time had only been to lease the premises to the Patels, and that was an exempt supply.

Further correspondence continued through 2006, including a request for details of all supplies ever made by the company. This information was provided by the taxpayer on 23 October 2006. An officer issued a letter on 2 February 2007 setting out the adjustments that would be made on the basis that the registration should be treated as valid, but the rules of partial exemption would require the VAT on the purchase and renovation of the property to be disallowed. An assessment was issued on 26 February 2007, correcting the earlier letter which the officer said had included a transposition error.

Date assessment raised

The Tribunal discussed the problems identified in earlier cases about the lack of statutory rules about when an assessment is "made". It is HMRC's practice, set out in Notice 915, that they will not rely on the probably correct legal interpretation of "*when the officer has taken all steps necessary to establish to the best of his judgement that a quantified sum was owed for a given reason*": they will instead rely on the date that an assessment is notified to the trader. A pre-assessment letter will not qualify as notification.

On these grounds, the Tribunal held that the letter of 2 February was sufficiently clear to qualify as an assessment. It was transparent and it was dated, and the transposition error was not significant.

Knowledge of facts

The appellant argued that the assessment arose out of the conclusion of the first investigating officer that the option to tax should be disapplied. This had never been disputed by the company, and the assessment could therefore have been raised at a much earlier date. The taxpayer had only ever argued that its VAT registration should be kept open. That dispute

was settled finally by the provision of information in October 2006, but that was not critical to the raising of the assessments for the 2004 periods.

The Tribunal agreed with HMRC that the appellant had kept the whole dispute alive by "moving the goalposts" at various stages. It was only in October 2006 that the officers could be sure what sort of assessment action was necessary – cancellation of registration or disallowance under the rules of partial exemption. This was the last piece of the jigsaw, and it was essential to the assessments that were raised in February 2007. The assessments were therefore in time.

VAT Tribunal (20,882): *Kidz R Us Children Centre Ltd*

3.2.2 Rent or VAT?

A landlord served a statutory notice on a tenant requiring the payment of outstanding rent and, when this was not paid, instituted proceedings to evict the tenant under the Agricultural Holdings Act 1986. The tenant objected, arguing that the notice to pay rent was invalid for the purposes of the Act because some of the amounts claimed were not "rent" – they were VAT, following the exercise of the option to tax by the landlord. The Act does not refer to whether "rent" is the gross or net amount, presumably because it predates the introduction of the option to tax.

The tenant argued that the exercise of the option to tax was a unilateral act by the landlord which could not vary the "rent": under the Act, "rent" could only be varied by agreement in accordance with a regular cycle of rent reviews.

The High Court disagreed with the tenant. The modern meaning of "rent" was the total consideration due for the tenant's right to possess the land. Where the option had been exercised, that included VAT. Although the Act protected the tenant from a number of possible unilateral actions by the landlord, it was hard to conclude that the exercise of a statutory right by the landlord in accordance with an Act of Parliament was against public policy. The notice was not ambiguous and was validly issued.

High Court: *Mason v Boscawen*

3.2.3 Option reviewed

There is an article reviewing the 2008 changes to Schedule 10 in *Tax Adviser*, December 2008.

3.3 Developers and builders

3.3.1 Housebuilders

There is an article by Neil Warren reviewing a number of issues for housebuilders in *Taxation*, 9 October 2008. These include the application of reduced rate, items which qualify as building materials, and the recent HMRC statement about changes of intention before the first use of a residential property.

3.3.2 Annexes

A sixth form college carried out a phased project to expand its buildings. One part of this programme involved the construction of a new teaching block. HMRC accepted that the building was to be used for a relevant charitable purpose, but ruled that it was an annexe that was not capable of being used independently of the main building. It therefore failed the test in Notes 16 and 17, Group 5 Sch.8 VATA 1994, and the construction was properly standard rated.

The Tribunal considered the relationship between the various buildings in detail. HMRC's main argument was that the teaching block could not function independently because it was simply part of the school: it must depend on the rest of the facilities to which it was attached.

The Tribunal was particularly concerned with the fact that the new block had no washrooms. It was not reasonable to expect people to attend class but not be able to use the lavatory; therefore the buildings were not capable of independent functioning. The appeal against HMRC's ruling was dismissed.

VAT Tribunal (20,816): *East Norfolk Sixth Form College*

The Tribunal had to consider whether a major building project at an individual's home qualified for zero-rating. HMRC argued that the project, which included the demolition of outbuildings and the construction of a swimming pool and other facilities, only created an "annexe". The Tribunal agreed that most of the work was an extension to an existing building and therefore failed to qualify for zero-rating; there was a flat which was capable of being a dwelling, but its separate use was prohibited by planning consent, and the Tribunal took the view that the prohibition of either separate use or separate disposal was enough to deny zero-rating.

VAT Tribunal (20,889): *M J Bracegirdle*

3.3.3 Wall

A synagogue arranged for the construction of a wall enclosing a cemetery. HMRC ruled that the work was standard rated. The synagogue appealed. The Tribunal dismissed the appeal, holding that the wall did not qualify as a "building", and therefore could not fall within any of the headings of Groups 5 or 6 Sch.8 VATA 1994.

VAT Tribunal (20,809): *Adath Yisroel Synagogue*

3.4 Input tax claims on land

Nothing to report.

3.5 Other land problems

Nothing to report.

4. INTERNATIONAL SUPPLIES

4.1 E-commerce

4.1.1 E-services

HMRC have issued information sheets to clarify the treatment of specially registered e-traders both in general and in relation to the change of VAT rate.

Information Sheets 10/2008 and 11/2008

HMRC have also announced that Latvia has increased its rate for the special scheme from 18% to 21% with effect from 1 January 2009.

Information Sheet 12/2008

4.2 Where is a supply of services?

4.2.1 Business and non-business use

Where art.56 (old art.9(2)(e)) 6th Directive services are provided by a supplier to a customer in another member state:

- the supplier charges VAT in its own state if the customer is not in business;
- the customer accounts for a reverse charge in its state, and the supplier treats the supply as outside the scope of VAT, if the customer is a taxable person. A customer who is in business may have to register for VAT in order to account for a reverse charge, as the supply is treated as supplied by the recipient for the purposes of the registration tests.

The 6th Directive provision refers to the place of supply being shifted to the customer's location if the supply is made "to taxable persons established in the Community but not in the same country as the supplier". The UK legislation is worded slightly differently (SI 1992/3121 reg.16):

"[where the recipient] is a person who belongs in a member State, but in a country other than that in which the supplier belongs, and who—

(i) receives the supply for the purpose of a business carried on by him; and

(ii) is not treated as having himself supplied the services by virtue of section 8 of the Act…"

The UK law specifies that the recipient must receive the supply for the purposes of a business activity for the reverse charge to apply. This was considered in the case of *Diversified Agency Services Ltd (aka Omnicom UK plc) v C & E Commrs* (High Court 1995): a UK advertising agency supplied services that were within Sch.5 to the Spanish Tourist Board, a VAT-registered entity in Spain. It thought that the supplies were outside the scope of UK VAT, but the court agreed with Customs that the services were received by the customer in connection with its statutory, non-business role in Spain, and the place of supply was therefore not shifted by

reg.16. Later the Tourist Board tried to recover the VAT charged under the 8th Directive, but that was also refused by Customs and the UK Tribunal.

The ECJ has now confirmed the Advocate-General's opinion in a Swedish case which suggests that the UK rule, and therefore the *Diversified Agency Services* decision, is wrong. The 6th Directive only refers to the customer being "a taxable person": the question referred by the Swedish authorities specifically set out the same circumstance – a Swedish entity with business and non-business activities, registered for VAT, wanted to buy in art.56 services from a Danish supplier for the purposes of its non-business activities. The Swedish authorities ruled that it would be subject to the reverse charge in Sweden (rather than, presumably, Danish VAT). An appeal against this ruling was referred to the ECJ for a ruling.

The court answered the question by stating that art.56(1)(c) of the 6th Directive "*must be interpreted as meaning that where the customer for consultancy services supplied by a taxable person established in another Member State carries out both an economic activity and an activity which falls outside the scope of those directives, that customer is to be regarded as a taxable person even where the supply is used solely for the purposes of the latter activity*". That means that it is the VAT of the customer's state that gets charged (and presumably cannot be recovered), rather than the VAT of the supplier's state.

Submissions were made by a number of governments but not the UK; the Italian government was the only one to put forward the *Diversified Agency Services* line, and the Advocate-General's opinion states: "*I would briefly mention that in the light of the above considerations it would appear that, in its construction of the relevant provisions, the Italian Government has not taken due account of the purpose of those provisions.*"

HM Revenue & Customs may seek to amend the UK law to reflect the decision. Changes to the place of supply rules in 2010 may have led to this result being implemented in the UK in any case, but in the meantime it appears possible for a UK trader to get the best of both worlds:

- to rely on the clear wording of the UK law in s.8 VATA 1994 ("*received by a person ["the recipient"] who belongs in the United Kingdom for the purposes of any business carried on by him*") to not account for a reverse charge when buying supplies from abroad for a non-business purpose, even if registered here;
- to rely on the 6th Directive and this decision to not charge VAT to registered customers elsewhere in the EU, even if the supply is to be used for their non-business activities.

ECJ (Case C-291/07): *Kollektivavtalsstiftelsen TRR Trygghetsrådet v Skatteverket*

4.2.2 Sales lists

HMRC have published a Revenue & Customs Brief to publicise a new requirement that businesses provide HMRC with EC Sales Lists for certain taxable supplies of services from 1 January 2010. This requirement, which arises out of the implementation of the "VAT package", affects all UK businesses that make taxable supplies of services to business customers in other EU countries where the customer is required to account for VAT under the reverse charge procedure.

They will not be required for:

- supplies which are exempt from VAT according to the rules in the Member State where the supply takes place;
- B2B supplies where the recipient is not VAT registered;
- B2C supplies.

At the present time HMRC anticipate using the same form that is used for reporting goods (VAT 101) and to require the following data:

- country code;
- customer's VAT Registration Number;
- total value of supplies in sterling;
- an indicator will also be required to identify services.

HMRC note that member states are currently discussing the tightening of the proposed rules to require sales list reporting on a monthly rather than a quarterly basis. They have received protests from traders about this idea and have fed them into the discussion at European level. Further comments are invited by e-mail to vat.package@hmrc.gsi.gov.uk.

R&C Brief 53/08

There is an article reviewing various aspects of the VAT package in *Tax Adviser*, September 2008.

4.2.3 Consultation

HMRC have issued a consultation document to seek comments on whether the draft UK legislation to implement the VAT package fully enacts the EU law. Other comments on issues of interpretation will also be welcomed. The consultation document identifies the main elements of the VAT package as:

- changes to the rules on Place of Supply of Services for both Business-to-Business (B2B) and Business-to-Consumer (B2C) transactions (Council Dir 2008/08/EC);
- requirement to complete EC Sales Lists for supplies of taxable services subject to the reverse charge (Council Dir 2008/08/EC);
- the introduction of an optional One Stop Scheme for accounting for B2C supplies of telecoms, broadcasting and electronically supplied services (Council Dir 2008/08/EC);
- the introduction of an electronic VAT Refund Scheme (Council Dir 2008/09/EC)—this will be covered in a separate consultation process; and

- enhanced administrative co-operation between Member States to support these changes (Regulation EC 143/2008).

HMRC explain that the new general rule for B2B services (supplied where received) extends to:

- Intermediary services;
- Transport of goods (including intra-Community transport of goods);
- Ancillary transport services (loading, unloading, etc);
- Valuation and work on goods;
- Long-term hire of a means of transport (more than 30 days for all means of transport other than vessels – more than 90 days);
- Electronically supplied services by non-EC suppliers to EC business customers;
- Services currently covered by Schedule 5 of the VAT Act 1994.

However, the new B2B general rule excludes:

- Services connected with immovable property (land);
- Passenger transport;
- Short-term hire of means of transport;
- Services and ancillary services relating to cultural, artistic, sporting, scientific, educational, entertainment or similar activities, such as fairs and exhibitions, including the supply of services of the organisers of such activities, that are supplied where they are physically performed;
- Restaurant and catering services;
- Restaurant and catering services supplied on ships, planes and trains.

4.3 International supplies of goods

4.3.1 Simplified import VAT accounting

HMRC have updated their guidance on the SIVA system in the form of "frequently asked questions" on the website. The information is provided under the following headings:

- Section 1: SIVA Basics
- Section 2: Approval Criteria
- Section 3: Application Process
- Section 4: Authorisation Process
- Section 5: Appeals Process
- Section 6: Guarantees
- Section 7: Declaration Process
- Section 8: Additional Information

http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageImport_ShowContent&id=HMCE_PROD1_023764&propertyType=document

In a recent Tribunal case, a company appealed against a ruling by HMRC which withdrew its right to operate SIVA. The company had exceeded the agreed limits for the scheme 6 times in the previous 12 months; HMRC regarded this as a risk to the revenue because the level of VAT due from the company was not adequately covered by the security. The Tribunal dismissed the appeal, holding that "the evidence shows that the appellants had adequate information and time to amend the level of DGL [Deferment Guarantee Limit] but that it failed to do so in a reasonable time, even though the Appellant was aware that SIVA would be removed for non-compliance."

VAT Tribunal (C00264): *Newstar Jeans Company Ltd*

4.3.2 A different missing trader problem

A Northern Ireland company sold ex-lease vehicles to customers in the UK, charging VAT as input tax had been recovered on the purchase. It was approached by two men claiming to represent a company in the Irish Republic. On the strength of a VAT registration number and bankers' drafts, the NI company sold cars to these men and zero-rated them as despatches. Later a non-VAT problem with the customers revealed that the men were not who they said they were. The NI company contacted HMRC to make sure that they were acting properly, and ended up being assessed for failing to meet the conditions for zero-rating.

The director of the company explained that an employee had checked the registration number to the Commission's website. The Tribunal accepted that the director believed that this had been done, but they did not accept that it actually had been done: the recorded number was not in the correct format for an Irish VAT number, and a check should have revealed that the company concerned had been deregistered some time before.

The trader argued that it should be protected from an assessment by the ECJ's decision in *Teleos*. There, a trader who had taken all reasonable

steps and who had been deceived by plausible documentation was held not to be liable to lose the benefit of zero-rating. However, the Tribunal did not accept that this trader was in the same position. It did not appear that reasonable care had been taken.

There were a number of interesting details in the decision:

HMRC were willing to ignore the fact that the customer's VAT number did not appear on the sales invoices. This is officially a condition for zero-rating, but if the customer had been VAT-registered, HMRC would not have considered it a significant failing. As the customer was not VAT registered, the presence or absence of the VAT number on the invoice would not help ensure zero-rating.

The company had not filed intrastats or sales lists. The Tribunal emphasised that these are not a condition of zero-rating sales, but the absence of them undermined an argument that the trader was conscientious and was taking all reasonable steps to comply with obligations.

A major problem with the trader's case was that there was no evidence that the immediate customer had removed the vehicles to the Irish Republic. The only evidence retained was a subsequent check that the vehicles had been registered for use on the public roads in Ireland. That suggested that they had been removed, but it did not confirm who had done this. Even if the customers might be taxable persons, there was no evidence that the conditions for zero-rating a despatch were met.

VAT Tribunal (20,891): *Appleyard Vehicle Contracts Ltd*

4.3.3 Intrastat limits

The annual limits of despatches and acquisitions for filing intrastat returns rise from £260,000 to £270,000 on 1 January 2009. The level at which delivery terms must be reported also rise, from £14.5m to £16m a year.

HMRC have also commented that they will be publishing regulations shortly which will take some small traders out of the intrastat system altogether from 2010.

R & C Brief 61/08; SI 2008/2847

4.3.4 Personal imports

The allowances that apply to travellers bringing general goods in from third countries VAT and duty-free are increased from 1 January 2009 as follows:

- Total value £340 or less (£300 during December 2008, £145 before that), if the person travelled by air or sea.
- Total value £240 or less, if the person did not travel by air or sea (£210 during December 2008, £145 before that).

It is not immediately clear how a person can enter the UK from outside the European Economic Area other than by air or sea. However, it appears that use of private aircraft or vessels does not count for the higher limit.

There are other changes to the limits for alcohol and tobacco.

SI 2008/3058

HMRC have issued some guidance for travellers and online shoppers on what they can expect to pay in duties and VAT.

http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageTravel_ShowContent&id=HMCE_PROD1_028719&propertyType=document

HMRC Press Release 1 December 2008

Updated Notice 1: Customs guide for travellers entering the UK

4.3.5 Post-clearance recovery

HMRC have commented that they have inconsistently handled post clearance recovery of import VAT. In the interests of consistency and customer transparency, the minimum amount which they will collect from 1 December 2008, for the foreseeable future, will be €22/£18.

CIP (08) 75 27 November 2008

4.3.6 New Means of Transport

HMRC have issued an updated edition of Notice 728 New Means of Transport. The technical content is largely unchanged but some clarifications are inserted. The revision also amends and corrects the address of the Personal Transport Unit (PTU) and the DVLA office details.

Notice 728

4.3.7 Online guidance

HMRC have published online guidance on the assurance procedures for the supply of tax-free vehicles under the Personal Export Scheme. It covers the basic principles, the procedures for supplying vehicles under the scheme, the assurance procedures and the paperwork.

www.hmrc.gov.uk/manuals

4.3.8 Groups of companies

There is an article reviewing cross-border transactions within groups in *Tax Adviser*, September 2008. The article considers the application and implications of the *FCE Bank* case, in which the ECJ confirmed that there can be no supply of services and therefore no reverse charge where a branch enters into a transaction with its head office.

4.4 European rules

4.4.1 Commission and fraud

The Commission has presented plans to prevent or detect VAT fraud and to recover taxes. These include measures which are intended to:

- prevent potential fraudsters from abusing the VAT system including: common approach to the registration and de-registration process of VAT taxable persons in the EU; on line confirmation available to traders of the validity of the VAT identification number of their customer; simplification, modernisation and harmonisation of the current rules on invoicing
- enhance the tools for the detection of VAT fraud, in particular by the creation of a European network, called Eurofisc, for closer operational cooperation between Member States;
- strengthen the possibilities for tax authorities to recover VAT losses in cross-border cases (including improvement of the mutual assistance between tax authorities for the recovery of taxes, introduction of shared responsibility for the protection of all VAT revenue independently of the Member State to which it is due).

The Commission has also adopted two specific measures to amend the VAT Directive: the first concerns the VAT exemption at importation (onward supply relief) and the second the possibility of making the supplier of goods liable for the VAT loss created by his missing customer in another Member State.

For onward supply relief to apply, the importer shall clearly indicate to the Member State of import his VAT identification number, the VAT identification number of his customer and he shall prove that the imported goods will be transported to another Member State.

A trader will also be responsible for the VAT loss created by a missing customer when the supplier contributed to the loss by not reporting (or by reporting false or incomplete information or by reporting late) his supply to his VAT authority.

http://ec.europa.eu/taxation_customs/index_en.htm

http://ec.europa.eu/taxation_customs/taxation/vat/control_anti-fraud/reports/index_en.htm

IP/08/1846

Notice 702/7 *Import VAT relief for goods supplied onward to another country in the EC* was reissued in an updated version by HMRC on 28 November 2008. However, under “what’s changed” it only says “This notice has been amended to include the recast of the 6th VAT Directive (now The Principal VAT Directive and SAD Harmonisation changes)”. It may be that a further update is needed shortly to reflect the changes announced by the Commission.

Notice 702/7

4.4.2 Res judicata

An interesting question has been referred to the ECJ by the Italian Supreme Court. It appears that an Italian taxpayer wants to rely on a binding Italian precedent which goes against EU case or statute law:

Does Community law preclude the application of a provision of national law, such as Article 2909 of the [Italian] Civil Code, laying down the principle of res judicata, where the application of that provision would lead to a result incompatible with Community law, thereby thwarting its application, even in areas other than State aid (in relation to which, see Case C-119/05 Lucchini SpA [2007] ECR I-0000) and, in particular, in matters relating to VAT and with respect to the misuse of rights in order to obtain undue tax savings, in particular in the light also of the rules of national law — as interpreted in the case-law of this Court — according to which, in tax disputes, where a giudicato esterno [a final judgment drawn up by another court in a case on the same subject] contains a finding on a fundamental issue common to other cases, it has binding authority as regards that issue, even if it was drawn up in relation to a different tax period?

ECJ (reference) (Case C-2/08): *Amministrazione dell'Economia e delle Finanze Agenzia delle Entrate v Olimpiclub Srl*

4.4.3 Reduced rates

The Commission has issued Taxation Paper 13, which is a study on the impact of reduced rates on job creation, economic growth and the internal market.

The study, by Copenhagen Economics, concludes:

- There are strong general arguments for having just one VAT rate per member state. A single rate can improve economic efficiency, reduce compliance costs and smooth the functioning of the internal market.
- However, reduced rates in selective cases may have merit. They can increase efficiency by increasing productivity or by reducing structural unemployment, and/or enhance equity by improving the income distribution or by making particular products more accessible to the entire population.
- In the areas where efficiency or equity can be improved in a cost effective manner by way of reduced rates, adverse internal market effects such as distorted competition across borders are for the most part insignificant. In contrast, there are a number of other areas where reduced rates are detrimental to the internal market without having strong positive impacts on national objectives.
- Targeted direct budget subsidies can often achieve better results at lower costs than reduced VAT rates, which should be factored into discussions on the use of reduced VAT rates.

http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/economic_analysis/tax_papers/taxation_paper_13_en.pdf

4.4.4 Input tax blocks

Member states are permitted to retain input tax blocks that were in force in the legislation in their country when the 6th Directive took effect there.

However, it is not permitted to extend the blocking of input tax that is incurred for business purposes. The ECJ has recently confirmed that this extends to the repeal of the blocking measure and its replacement with a different provision, if the effect of that different provision is to extend the disallowance of business-related input tax.

ECJ (Case C-414/07): *MAGOORA Sp. z o.o. v Dyrektor Izby Skarbowej w Krakowie*

4.4.5 Italian amnesty – again

The last update reported Case C-132/06 in which the ECJ gave a declaration as requested by the Commission that Italy's failure to check VAT payments amounted to a contravention of the 6th Directive. The Italian authorities had argued that their amnesty for past returns was a measure that led to collection of more tax than they would have obtained otherwise, and was within the latitude for simplification procedures allowed to member states.

Italian law extended the amnesty to the tax year 2002 as well, and the ECJ has given another declaration that this is in breach of the Directive.

ECJ (Case C-174/07): *Commission v Italy*

4.5 Eighth Directive reclaims

Nothing to report.

5. INPUTS

5.1 Economic activity

5.1.1 Not for business purpose

An individual ran a hotel business which he disposed of in December 2003. Subsequently he continued to claim input tax on a number of expenses, but it appeared to relate to the letting and sale of residential property rather than any taxable activity. He was too unwell to attend the Tribunal hearing, and the chairman was at pains to consider the possibility that there were any valid grounds for claiming the input tax – including considering the ECJ judgment in *I/S Fini* which might have justified late payments of expenses that related to the ceased business – but could find none. The appeal against an assessment disallowing the input tax was dismissed.

VAT Tribunal (20,872): *Douglas O Shackson*

5.2 Who receives the supply?

5.2.1 Loyalty points

HMRC have issued a second Brief explaining the current state of the appeal in *Loyalty Management UK*. The Court of Appeal found that payments by LMUK to retailers who redeemed loyalty points were for "redemption services", and the VAT included was deductible as input tax by LMUK.

HMRC maintain that the payments are third party consideration for goods and services supplied by those retailers to individuals; as LMUK does not receive those supplies, it cannot claim input tax. The House of Lords granted HMRC leave to appeal in April, and the earlier Brief (46/08, issued 17 September 2008) stated that the Lords have decided to refer questions to the ECJ. It will therefore be some time before the outcome of the litigation is known.

The earlier Brief pointed out that some redeemers are adversely affected by the Court of Appeal's ruling: they may be supplying zero-rated goods, but they have to account for output tax because redemption services are not a zero-rated supply. The Court's decision is the current law, so they should comply with it and raise VAT invoices for the full amount payable by LMUK. However, they may wish to make protective claims for repayment in respect of possibly overpaid output tax.

Redeemers who supply goods only for points (as opposed to part payment) are also, under the Court's view of the law, making supplies within Sch.4 para.5 (business gifts). HMRC say that they will protectively assess for output tax on that basis (presumably where the cost of the goods exceeds £50).

The second Brief makes it explicit that any previously issued guidance or rulings on the subject are rescinded with effect from 17 September 2008. Any redeemers who have contrary rulings cannot rely on them after that date.

Revenue & Customs Brief 60/08

5.3 Partial exemption

5.3.1 Special method override

In 2001 HMRC agreed a floor-area based special partial exemption method with a chain of opticians' stores. In 2005 they issued an override notice under reg.102A SI 1995/2518, cancelling the special method and replacing it with "the extent to which the goods or services are used by him or are to be used by him in making taxable supplies". The company appealed against the issue of the notice.

The Tribunal agreed with the earlier criticisms of the Tribunal and High Court in *Optika* and *Banbury Visionplus*: the problem with a floor-area based method in an open-plan optician's shop was that very little of the space was used exclusively either to make taxable or exempt supplies. As a result, the special method did not represent a fair, or fairer, method of attributing and apportioning input tax. The override notice was properly issued, and was not ambiguously worded so as to make it invalid.

The Tribunal also dismissed an appeal against an assessment for input tax overclaimed by the company. The Tribunal considered only matters of principle in relation to this assessment: it did not consider the assessment in detail, but as it arose from the issue of the override notice, it was valid in principle.

The Tribunal made the following comment about what might be an acceptable special method:

"*We have already indicated that we think it unlikely that a floor area-based method could ever be suitable. We heard some evidence about the calculations, referred to as a "full cost apportionment", VEUK makes in order to determine the taxable and exempt proportions of the charge it makes for dispensed spectacles and the slightly different calculation it makes in respect of contact lenses. We are aware that the Commissioners have misgivings about the calculations, but as we understood the matter, their misgivings relate to the details of the calculation, rather than to the principle. The more we heard evidence on the matter, the more it seemed to us clear that a method which satisfactorily calculates VEUK's output tax liabilities is as likely, perhaps with adjustment for special factors, to represent a suitable method for calculating the input tax for which it is entitled to credit. We did not understand how an expense which is a cost component of a mixed supply must be treated in one way when calculating the output tax liability, and in another when calculating the input tax credit. In short, it appeared to us that the Commissioners were right to conclude that, in relation to the retail business taken alone, the standard method, perhaps with some small adjustment, was appropriate.*"

VAT Tribunal (20,870): *Vision Express (UK) Ltd*

5.3.2 Rounding in a special method

RBS agreed a special method which required the proportion of residual input tax to be rounded to two decimal places. The company subsequently reclaimed further input tax on the basis that the Directive required rounding to the nearest larger whole number (art.19(1)). HMRC refused the claim and the Court of Session referred questions to the ECJ for clarification of the relationship between art.19(1) and art.17(5) which permits member states to use special methods.

The Court ruled that "*Member States are not obliged to apply the rounding up rule in that provision where they employ the methods of calculation set out in (a), (b), (c) or (d) of the third subparagraph of Article 17(5) of that directive but may adopt their own rounding up rules, provided that they observe the principles underpinning the common system of VAT*". The standard method of partial exemption mentioned in the first part of art.17(5) was subject to the rules of art.19(1), but the rest of the article was not.

ECJ (A-G) (Case C-488/07): *Royal Bank of Scotland Group Plc v Revenue and Customs Commissioners*

5.3.3 New framework for educational establishments

HMRC have updated their guidance on Partial Exemption methods for the higher education sector. The changes include:

- additional explanation of teaching support grant;
- examples of the TRAC Variant 2 sub-option for costing, which has been developed more fully since publication of the original guidance; and
- a note on interaction with the capital goods scheme.

The details of the guidance will be of interest to those in the affected sectors, but they are specialised and therefore of limited general application.

HMRC Press Release 20 November 2008

5.3.4 Local authorities

The last update reported that HMRC have abandoned their proposals for simplifying local authority partial exemption calculations. HMRC had previously put forward the idea of a "sector calculation" to demonstrate that local authorities, as a whole, did not incur exempt input tax greater than 5% of their combined input and s.33 refund tax, in which case it might be regarded as de minimis. HMRC have now formed the view that this is not a viable option and they intend to start a new review to identify an alternative.

Many authorities have expressed concern about the lack of guidance for the coming financial year. HMRC have confirmed that, having taken legal advice, the moratorium on partial exemption calculations will not be extended to 2009/10. Local authorities will therefore be required to resume monitoring their exempt input tax in accordance with the regime that existed prior to the 2007/08 moratorium.

5.4 Cars

5.4.1 Car or collector's item?

In the case of *Paul* (C00210), the Tribunal agreed with Customs that a 1964 Bentley was a car, not a collector's item, for the purpose of import duty and VAT. Another similar argument arose in respect of a 1955 Ford Zephyr Mark 1 from New Zealand.

Customs argued that the car was not valuable enough to be a collector's item. The Tribunal held that Customs' approach should not be regarded as a rigid set of rules: it was necessary to compare the value of the car with the value of its constituent parts. If it was significantly more valuable as a whole vehicle, it was capable of being a collector's item.

The conditions laid down by ECJ precedent (*Erika Daiber v Hauptzollamt Reutlingen* (Case 200/84)) are:

- that the article must be "relatively rare";
- that the article is "not traded on the ordinary market" and/or that it is "handled by a specialized trade";
- that the article "may fetch a high price";
- that the article is "not normally used for [its] original purpose, although it cannot be ruled out that [its] functional capacity may remain intact"

HMRC operated a "rule of thumb" for "high value" – the estimated selling price of the car had to be at least £20,000 for it to qualify as a collector's item. If it failed this test, it could not qualify; if it passed, other conditions still had to be met. In this case, HMRC accepted that the other three main conditions were met, but disputed the "high value" of the car.

Both the Tribunal and the High Court have allowed the individual's appeal against HMRC's ruling. The judge commented that HMRC's "rule of thumb" was unreasonable, arbitrary and not supported by the ECJ decision. The value of the car as a collector's item was several times higher than any other value that could have been ascribed to it (whether for scrap, spare parts or the utility value of using it as a car), and that satisfied the legal test.

High Court: *HMRC v West*

5.5 Business entertainment

Nothing to report.

5.6 Non-business use of supplies

5.6.1 Yacht

A trader's business comprised consultancy in the development of thinking skills. He purchased and refitted a yacht for the business purpose of stimulating creative thinking. HMRC did not accept that there was a sufficient link between the expenditure and the business, and the Tribunal agreed. The input tax was not deductible.

VAT Tribunal (20,884): *Independent Thinking Ltd*

5.6.2 Swimming pool

The ECJ has confirmed again that a VAT-registered trader is entitled to full and immediate input tax deduction on an asset purchased for part business, part private use, charging output tax later to reflect the private use. The case is particularly striking as the Austrian trader had a house constructed with a swimming pool. The authorities were willing to apply the principle to the cost of the house, but not to the cost of the swimming pool. The referring court was worried that a registered trader might be regarded as obtaining an advantage over other individuals that would constitute an unauthorised State Aid.

The ECJ's response was:

1. There is no infringement of the principle of equal treatment in the fact that the Community VAT directives entitle a taxable person to full and immediate deduction of input tax on property which he acquires and allocates to his business, then paying output tax progressively on his private use of that property, even if he thus enjoys an identifiable financial advantage over another person acquiring similar property in a private capacity and thus unable to deduct any input tax.

2. National legislation implementing the Community VAT directives so as to allow taxable persons such an advantage does not infringe Article 87 EC.

3. The standstill clause in Article 17(6) of the Sixth VAT Directive does not cover cases in which a previous exclusion from the right to deduct input tax where output tax was in principle chargeable is subsequently transformed into an exemption from output tax, entailing the impossibility of deducting input tax.

4. If a previous exclusion from the right to deduct is thus transformed into an exemption and is therefore not covered by the standstill clause in Article 17(6) of the Sixth Directive, any other exclusion which is dependent for its interpretation and/or application on the existence of the previous exclusion will also not be covered by the standstill clause. However, a self-standing exclusion which was in existence when that directive came into force in the Member State concerned and has not since been modified remains covered by the clause.

ECJ (Case C-460/07): *Sandra Puffer v Unabhängiger Finanzsenat, Außenstelle Linz*

5.7 Bad debt relief

5.7.1 New Notice

HMRC have published an updated version of their Notice on bad debt relief. It explains that "*With effect from 1 January 2003 there are major changes to the way the bad debt relief scheme operates, this notice has been re-written to explain these changes and how it works for supplies made prior to, and on or after this date.*" It includes Update 1 (November 2008), which covered the changes made some time ago to the treatment of payments of instalment finance.

Notice 700/18

5.7.2 Online guidance

HMRC have published online guidance on the administration of bad debt relief. It covers payments, making claims, repayments of relief when the debtor subsequently pays, and repayment of input tax by the debtor.

www.hmrc.gov.uk/manuals

5.8 Other input tax problems

5.8.1 End of a line of appeals

A company was involved in a string of appeals concerning allegations of missing trader fraud. The issue was whether the trader knew or ought to have known that the transactions were tainted by fraud. The Tribunal formally dismissed 9 appeals with the consent of the taxpayer, but noted that the costs would be paid by HMRC.

The previous visit of the company to the Tribunal (19,831) in July 2006 led to preliminary rulings on the burden of proof and the meaning of the expression "knew or ought to have known". The Tribunal allowed HMRC to amend their statement of case to reflect the rulings on these issues. It appears that the trader felt that it was not worthwhile to pursue the appeals further in the light of the Tribunal's views on the legal principles, but it seems that we will not see the underlying facts examined in a Tribunal report.

VAT Tribunal (20,868): *Dragon Futures Ltd (in administration)*

5.8.2 Several carousels

HMRC have had several successes in appeals by traders who have been caught up in carousel frauds. In these cases HMRC tend only to go for the VAT – there is not even a s.63 penalty, let alone a s.60 penalty or a prosecution at issue – but in some of them the Tribunal was satisfied that the traders knew what was going on.

In one case, the appellant company was assessed to output tax on the basis that the despatch documents were probably falsified so the supplies did not qualify for zero-rating. The company's problem was that the supply was most unusual, and it was difficult to regard it as a straightforward business deal: accordingly, detailed investigations should have been carried out to

make sure that it was not tainted with fraud, and the Tribunal was not satisfied that such investigations were carried out.

The company's documentation showed that a large consignment of mobile phones had been despatched to an address in the Netherlands. At the last minute, it had decided not to proceed with a sale to a Belgian customer because doubt had been cast over whether it was validly VAT-registered; but another customer offered to buy the same phones for the same price for delivery to the same address. As this company was in Madeira, this seemed exceptionally convenient. The Netherlands address turned out to be a private house.

The Tribunal did not believe that the company could rely on the ECJ's decision in *Teleos* to preserve the benefit of zero-rating. Rather than carrying out all reasonable steps to be satisfied that its transactions were not tainted with fraud, it seemed that the company did what it thought would satisfy HMRC. There were many aspects of its business that did not seem reasonable for normal commercial transactions:

"*What is in our view most significant is that N2J took almost everything on trust: it relied on third parties (that is, K & L Logistics, who had been engaged by its own suppliers) for assurance that the goods existed, and were what they were claimed to be, undertaking no inspections of its own; it agreed to their being transported to a warehouse of which it knew nothing and with whose proprietor it had had no direct contact; it arranged no insurance of the goods; it accepted payment by instalments with no agreement on the time over which payment would be made; and it had no fall-back arrangement if Pro-Choice should default. When one adds those factors to N2J's lack of any curiosity when it found that Pro-Choice was willing to buy exactly the same goods as N2J had already agreed to sell to Imex, at exactly the same price, and that it wanted the goods delivered to the same warehouse, in a country remote from its own base, one would have thought that alarm bells would immediately start ringing. Miss Abreu was not merely vague in her recollection. It was clear to us as she gave her evidence that she felt very uncomfortable, and we came to the conclusion that she did indeed have misgivings at the time about what she was being required to do by her employers.*"

The appeal against the output tax assessment was dismissed.

VAT Tribunal (20,895): *N2J Ltd*

Cases concerning input tax claims appear to involve far more work for HMRC and the Tribunal – the reports are very long. A succession of deal chains has to be examined to show that there is a VAT loss and to investigate whether the trader knew, or had the means of knowing, that this would be the case.

In one case, the Tribunal examined the evidence in detail, then commented on "…*the sheer improbability of these trades being genuine. In particular we take account of the following:*

(i) the exponential increase in Red 12's turnover despite no capital and no assets;

(ii) by February 2006 Mr Singh, who had some previous commercial experience, had been operating in the field for long enough to know of the considerable risk of fraud and yet his checks on his suppliers were inadequate;

(iii) the inadequacy of the invoices;

(iv) the lack of any value added by Red 12;

(v) the length of the deal chains;

(vi) the volume of trade given Mr Taylor's evidence as to the availability of new telephones;

(vii) the peculiar circumstances of many of the deals, in particular Deal 25 (see paragraph 22(b));

(viii) Mr Singh's lack of credibility and lack of care with regard to his own terms and conditions, in particular in respect of potential liability."

The appeal was "allowed in part", because HMRC's grounds of assessment had been "missing trader intra-community fraud", and one of the deal chains was not proved to involve an intra-community transaction – it is not much of a victory to win because HMRC were alleging the wrong sort of fraud. Input tax was disallowed on all the other transactions.

VAT Tribunal (20,900): *Red 12 Trading Ltd*

In another case the Tribunal believed that the trader was too intelligent not to have known what was going on: all the deals were fraudulent, and it did not seem possible that the trader could have been ignorant of the true nature of his company's business. There were factors which suggested that he was creating a paper-trail to satisfy HMRC, for example paying a third party to carry out a "100% open-box inspection" of the phones in one transaction but then ignoring the fact that it was highly unlikely that this could have been carried out on 26,000 phones in the time available.

VAT Tribunal (20,894): *Megtian Ltd*

A fourth appeal involved 3,000 pages of exhibits. The Tribunal came to a similar conclusion to that in Megtian: the trader was too clever to be an innocent dupe. The conclusion was that his evidence was not truthful, and that he actually knew about the fraud. The appeal was dismissed.

VAT Tribunal (20,883): *Europeans Ltd*

5.8.3 Strike two

A UK company claimed zero-rating in respect of three despatches of carousel goods to an address in the Netherlands. The customer was supposedly registered for VAT in Spain. As the company had changed its business from supplying doors to supplying computer chips, Customs had warned it of the dangers of being involved in MTIC fraud; when it submitted large VAT reclaims these were investigated, and Customs refused to pay on the basis that a missing trader was at the start of each of the supply chains. It was accepted that the goods existed and the supplies took place as described, but the conditions for zero-rating had not been met.

The company appealed, contending that it was entitled to zero-rating because the customer was either actually registered in Spain, or else was a "taxable person" even if not registered.

The Tribunal examined the evidence and found that the Spanish company appeared to be wholly inactive, set up apparently for the purposes of carrying out carousel transactions by a UK resident. The Spanish authorities had removed it from the register of inter-community traders

because it suspected it was only established to be part of a fraud scheme. If the UK trader had checked with the Spanish authorities shortly before entering into transactions (as opposed to several weeks before) they would have discovered this.

The Tribunal was satisfied that the conditions for zero-rating in the UK law had not been satisfied (the customer was not validly registered for VAT in Spain) and that those conditions were in accordance with the 6th Directive. However, at the time of the first hearing (20,284) another trader was appealing a similar case to the High Court (*JP Commodities Ltd* (19,904)), and a final decision in this case was held over until that judgment was available. The basis of the appeal was that the UK company should be entitled to zero-rate a supply to a company in another member state simply because it is a "taxable person" on principle; in effect, the obligation to collect the missing tax should lie with the authorities in the member state of arrival, who should make sure that it registers and accounts for tax on the acquisition.

The *JP Commodities* appeal was unsuccessful, and the Tribunal dismissed the held over appeal as well.

VAT Tribunal (20,823): *Maine Distribution Ltd*

5.8.4 Confiscation

The Court of Appeal has considered the legal basis of confiscation orders made by a High Court judge against three individuals who were convicted of taking part in a carousel fraud. It is notable that the conviction was for taking part in facilitating the fraud, and there was no direct finding that the defendants had received the "missing VAT" (which had been misappropriated by traders in other jurisdictions). The confiscation order related to the finding that they had received "property" rather than "a pecuniary advantage" (s.71(4) rather than s.71(5) Criminal Justice Act 1988). The judge was entitled to make the findings and the order that he did.

Court of Appeal: *R v Sangha and others*

5.8.5 Inadequate evidence

A company purchased goods from two traders who drove unmarked vans selling clothing in the Commercial Road, East London. They provided VAT invoices and were paid in cash. The registration numbers belonged to "missing traders".

The Tribunal was at pains to point out that the upholding of the assessments and a misdeclaration penalty did not amount to a finding of any dishonesty on the part of the director of the appellant. He had simply failed to satisfy the burden of proof required to overturn the assessment, and the misdeclaration penalty was levied on innocent errors rather than fraudulent ones.

The chairman outlined a number of possible explanations for the facts, ranging from the possibility that the suppliers were in fact validly registered at the time the purchases were made, to the possibility at the other extreme that the director was party to a fraud involving the missing traders. It was difficult to determine which had actually occurred, but there was insufficient evidence to conclude that the conditions for an input tax deduction existed. The Tribunal referred to HMRC's 2003 Statement

of Practice on claiming input tax without a valid VAT invoice, and concluded that the trader had not done enough to be satisfied about the good faith of unidentifiable and untraceable suppliers. The appeals against assessment and penalty were dismissed.

VAT Tribunal (20,854): *Faith Clothing Ltd*

A similar point, and a similar conclusion, was considered in a case involving a company that had been defrauded by its former credit controller. He had destroyed a number of records when he left the company, and certain accounts had to be reconstructed. The company believed that there were VATable purchases from a particular supplier, but the Tribunal agreed that the evidence was not strong enough to show that HMRC were unreasonable to refuse to accept an input tax claim.

VAT Tribunal (20,837): *Global Star plc*

5.8.6 TOGC

An individual ran a hotel through a company. In a series of transactions over a number of years, he separated out the operation of a bar in the hotel which he ran personally, and later – when he suffered financial problems and had his estate sequestrated – he transferred the assets of the bar back to the company. HMRC visited the hotel earlier in the same year and ruled that a business splitting direction would be appropriate, although it appears that none was issued because the separation was ended instead.

When the assets were transferred back to the company, it claimed input tax. The individual, being insolvent, did not pay the output tax on this transaction to HMRC. HMRC disallowed the input tax for the company on the grounds that the transfer was a TOGC.

The Tribunal examined the background to the transactions and found the facts to be unusual. Nevertheless, it was clear that there was a transfer of the assets of the bar business as a going concern, and the appeal was dismissed. The connection between the parties and the clear intention to carry on running the bar within the hotel pointed to that conclusion.

HMRC applied for costs on the grounds that the transactions were "not genuine": however, this point had not been argued in the Tribunal, and costs were not awarded.

VAT Tribunal (20,855): *J & S Pubs Ltd*

5.8.7 Mileage rates

The HMRC approved "fuel-only mileage rates" are to be changed twice a year on 1 January and 1 July – at least, that has been the pattern over the last three years.

The rates can be used for two purposes for VAT:

- if the employee buys fuel, the employer can pay the mileage rate for business miles and HMRC will still accept an input tax claim based on 7/47 of the amount paid (as it is all for fuel);
- if the employer buys fuel, and the employee reimburses this mileage rate for private miles and HMRC will accept that the output tax scale rates do not apply. However, the employer will have to account for output tax on the amount received, as it is an actual supply of fuel to the employee for consideration.

The rates have fallen from 1 January 2009 as follows:

Engine size	Petrol	Diesel	LPG
1400cc or less	10p (12p)	11p (13p)	7p (7p)
1401cc – 2000cc	12p (15p)	11p (13p)	9p (9p)
Over 2000cc	17p (21p)	14p (17p)	12p (13p)

These figures are also an acceptable basis for estimating the fuel element of a mileage allowance paid to someone for use of their own car. HMRC will still allow an input tax claim based on mileage allowances, so if the employer pays 40p a mile to someone with a 2100cc car, it appears that 7/47 x 17p ought to be an acceptable basis for the input tax claim. Since 1 January 2006, however, it is a requirement that the employer holds input tax invoices which show at least the amount of the VAT that is being claimed on a mileage basis.

It is still open to all drivers, whether of their own cars or company cars, to make a claim based on actual costs. However, these mileage rates are likely to be a worthwhile simplification of that.

The Press Release contains a summary of the fuel consumption figures used to generate the above mileage rates, which may provide some indication of whether a particular car is likely to give a lower or higher "actual" figure.

Revenue & Customs Press Release 3 December 2008

6. ADMINISTRATION AND PENALTIES

6.1 Group registration

Nothing to report.

6.2 Other registration rules

6.2.1 Stock of registered traders

The Department for Business, Enterprise and Regulatory Reform (BERR) has reported the latest statistics on business start-ups and closures. The statistics were released on 28 November 2008.

The "stock" of VAT-registered enterprises increased by 57,900 (3%) during 2007, to reach 2.03 million at the start of 2008. There has been an increase in the stock of VAT-registered enterprises in every year since 1995, resulting in a 26% rise in the number of VAT registered businesses between the start of 1995 and the start of 2008.

In 2007, there were 205,700 new registrations – an increase of 13% on 2006 levels, and the highest number recorded since the series began in 1994. There were 147,800 de-registrations in 2007 – an increase of 2% on 2006 levels.

http://nds.coi.gov.uk/environment/fullDetail.asp?ReleaseID=385828&NewsAreaID=2&NavigatedFromDepartment=True

6.3 Payments and returns

6.3.1 Flat rate scheme entry and exit

The Pre-Budget Report included the announcement of clarification and simplification of the requirements for traders entering and leaving the flat rate scheme. These are:

- using only taxable turnover, rather than all turnover, when considering the £150,000 (VAT-exclusive) threshold for entering the scheme;
- using the figure the trader calculates for the VAT return (cash basis or invoice basis) in determining the £225,000 (VAT-inclusive) threshold for having to leave the scheme.

The problem with the exit test was highlighted earlier this year when HMRC confirmed that the invoiced figure should be used, even if the trader prepared VAT returns on a cash basis. This could lead to the peculiar result that the trader has to leave the scheme even though the VAT return shows a figure below £225,000 in Box 6.

A curiosity of the new scheme (which will be further clarified by later issue of regulations and a revised Notice) is that a trader could simultaneously be eligible to join the scheme and required to leave. HMRC point out that a trader with so much exempt turnover would

probably not wish to join the flat rate scheme because the flat rate would apply to that income.

PBRN 25

6.3.2 Flat rate scheme and the change of rate

The flat rates are reduced to take account of the lower standard rate, but not uniformly. This is explained in the guidance: some flat rates are low because the trader is forgoing a lot of input tax, and such rates should perhaps rise rather than fall because the amount of input tax forgone is reduced. However, no rates have been increased.

FRS traders will have to apply s.88 to their sales (rules described in section 2.6 above) and choose whether to charge 17.5% or 15% on the same basis as all other traders. The cut-off for flat rate then depends entirely on the correct outcome of the sales decision:

- if 17.5% was correctly charged to the customer, the old higher flat rate applies, whenever the customer pays;
- if 15% was correctly charged to the customer, the new lower flat rate applies, whenever the customer pays.

A FRS trader who uses the FRS version of cash accounting will have to keep receipts separate for pre- and post-change supplies.

The new rates are:

Category of business	New flat rate	Old flat rate
Post offices	2	2
Retailing food, confectionary, tobacco, newspapers or children's clothing	2	2
Wholesaling food	5	5.5
Farming or agriculture that is not listed elsewhere	5.5	6
Membership organisation	5.5	5.5
Pubs	5.5	5.5
Retailing that is not listed elsewhere	5.5	6
Retailing vehicles or fuel	5.5	7
Wholesaling agricultural products	5.5	6
Retailing pharmaceuticals, medical goods, cosmetics or toiletries	6	7
Sport or recreation	6	7
Wholesaling that is not listed elsewhere	6	7
Printing	6.5	7.5
Repairing vehicles	6.5	7.5
Agricultural services	7	7.5
Manufacturing food	7	7.5
General building or construction services*	7.5	8.5
Hiring or renting goods	7.5	8.5
Library, archive, museum or other cultural activity	7.5	7.5
Manufacturing that is not listed elsewhere	7.5	8.5
Manufacturing yarn, textiles or clothing	7.5	8.5
Packaging	7.5	8.5
Repairing personal or household goods	7.5	8.5

Forestry or fishing	8	9
Mining or quarrying	8	9
Social work	8	8.5
Transport or storage, including couriers, freight, removals and taxis	8	9
Travel agency	8	9
Veterinary medicine	8	9.5
Advertising	8.5	9.5
Dealing in waste or scrap	8.5	9.5
Hotel or accommodation	8.5	9.5
Manufacturing fabricated metal products	8.5	10
Photography	8.5	9.5
Publishing	8.5	9.5
Any other activity not listed elsewhere	9	10
Investigation or security	9	10
Boarding or care of animals	9.5	10.5
Business services that are not listed elsewhere	9.5	11
Entertainment or journalism	9.5	11
Estate agency or property management services	9.5	11
Film, radio, television or video production	9.5	10.5
Laundry or dry-cleaning services	9.5	11
Secretarial services	9.5	11
Computer repair services	10	11
Catering services including restaurants and takeaways	10.5	12
Financial services	10.5	11.5
Hairdressing or other beauty treatment services	10.5	12
Architect, civil and structural engineer or surveyor	11	12.5
Management consultancy	11	12.5
Real estate activity not listed elsewhere	11	12
Accountancy or book-keeping	11.5	13
Computer and IT consultancy or data processing	11.5	13
Labour-only building or construction services*	11.5	13.5
Lawyer or legal services	12	13

"Labour-only building or construction services" means building or construction services where the value of materials supplied is less than 10 per cent of relevant turnover from such services; any other building or construction services are "general building or construction services".

HMRC's further guidance on the change of rate, issued on 1 December 2008, contained the following guidance on the flat rate scheme:

> *Flat Rate Scheme and the change in the standard rate*
>
> *1. I'm on the Flat Rate Scheme. Why hasn't my rate fallen by 2.5%?*
>
> *The flat rates as a whole have been correctly adjusted to take account of the 2.5% reduction in the standard rate, but this doesn't mean that each of the flat rate amounts falls by 2.5%. There are two reasons for this.*
>
> *Firstly, the flat rate takes account not only of the VAT payable on sales, but also a number of other factors including the amount of VAT reclaimable on purchases and expenses and the level of VAT inclusive turnover. And because businesses are not the same - different types of*

business have different patterns of input and outputs - it is necessary to have different flat rates for different types of business.

Secondly, the flat rates are also reviewed annually to ensure that they reflect the net VAT paid by small businesses that do not use the flat rate scheme. This avoids distortion of competition between flat rate users and small businesses that opt not to use the Flat Rate Scheme.

2. My rate hasn't changed. Why?

There are a few types of business whose rates have remained unchanged – this reflects the combined effect of the standard rate reduction and the review of rates referred to above. Those flat rates that have remained the same would have needed to go up had the standard rate of VAT remained at 17.5%

3. Have any rates gone up?

No rates have gone up.

The changes introduced in the PBR cut the flat rate for the overwhelming majority of businesses – 50 out of 55 of the flat rate scheme categories have been reduced.

4. I no longer wish to use the flat rate scheme following these changes

We would normally expect you to apply for and leave the scheme at the end of an accounting period. Businesses can leave the scheme and account for VAT in the normal way by notifying HMRC in writing and we will notify you of the date you have left the scheme.

HMRC Press Release 1 December 2008

6.3.3 Retrospective application

A journalist had been registered for VAT from April 1989. He failed to realise until late in 2007 that the flat rate scheme would benefit him. He applied to be admitted to the scheme retrospectively from December 2002, which would lead to a repayment of over £20,000. HMRC said that there were no exceptional circumstances that should allow retrospective use of the scheme.

The journalist accepted that he had probably received the general publicity about the scheme and had not read it. However, he had had a VAT inspection in 2004, and he believed that the visiting officer should have drawn the scheme to his attention. The Tribunal noted that Notice 733 includes misdirection by an officer as a reason to backdate the application of the scheme, and concluded that the failure of the officer to mention it was misdirection by omission.

The effect of the ruling would be to allow a repayment of VAT relating to the three years before the application for retrospection, which was made on 10 July 2008. The Tribunal chairman held that the 3-year cap would deny a repayment for the earlier period.

VAT Tribunal (20,881): *David Eric Burke*

6.3.4 Online guidance

HMRC have published online guidance on the annual accounting scheme. It covers entering the scheme, structure of the annual accounting year, payments, operating the scheme, renewals, and removal from the scheme.

www.hmrc.gov.uk/manuals

6.4 Repayment claims

6.4.1 Compound interest

A number of mail order companies claimed repayments from HMRC in respect of a misunderstanding of the law that had persisted from 1973 to 2004. HMRC accepted that tax had been overpaid and repaid most of the VAT itself, together with simple interest calculated under s.78 VATA 1994. The companies commenced proceedings against HMRC, claiming that they were entitled to compound interest. The total claimed exceeds £1bn.

There is a similar dispute in progress between HMRC and a group of motor traders (who also were entitled to large repayments based on two long-standing misunderstandings concerning fleet discounts and sale of cars on which input tax had been blocked). HMRC applied to the High Court for a stay of proceedings in the mail order case because the issues were so similar to those in the other case. The application requested a stay of proceedings until 56 days after judgment was delivered in the motor dealers group litigation.

The court ruled that, in spite of many of the issues being common to both disputes, there was not a sufficient reason to stay the proceedings. The judge directed HMRC to serve its substantive defences to the claims for compound interest.

High Court: *Littlewoods Retail Ltd and others v HMRC*

6.5 Timing issues

6.5.1 Online guidance

HMRC have published online guidance on the cash accounting scheme. It covers entering the scheme, special circumstances, manipulation of the scheme, records and accounts, leaving the scheme, and issues relating to the tolerance levels for turnover.

www.hmrc.gov.uk/manuals

6.6 Records

Nothing to report.

6.7 Assessments

6.7.1 Accounting period

A company registered for VAT in 2001 on the basis that it was carrying on a restaurant business in succession to another company which had been struck off the Register of Companies. Customs decided that the business was actually run by four members of a family acting in partnership, and issued a notice of compulsory registration on them.

In 2006 the Tribunal reviewed all the evidence and decided that Customs were right. In effect, the company was a sham established to conceal the ownership of the business. Substantial amounts of business income were diverted to cover purely private expenditure of the family.

The effect of the compulsory registration (from 1995 onwards) was to bring various other activities within the scope of the same VATable trader, and to catch underdeclared takings. The total assessment was over £400,000.

The traders appealed, arguing that the assessment was invalid because it did not relate to an accounting period of the business. The assessment had been made "for the period from September 1995 to July 2002", but a registration certificate was not sent until January 2007 (backdated to September 1995). The certificate specified that returns should be made for the period to February 2007 and monthly thereafter.

The Court of Session agreed that the assessment was invalid. HMRC had the power under reg.25 SI 1995/2518 to direct the trader to use a particular accounting period: usually, where there was a backdated registration, that ran from the EDR to a date shortly after the certificate was issued. In this particular case, that power had not been exercised to specify a period that corresponded with the assessment. The normal rule was that accounting periods ran for calendar quarters, and the assessment did not correspond with them either.

The decision is a careful and precise analysis of the operation of reg.25 and it will probably be considered in some detail by HMRC to make sure that they do not make the same mistake again.

Court of Session: *The Raj Restaurant v HMRC*

6.7.2 Best of judgement

A company appealed against a "best of judgement" assessment but was not represented at the hearing. Even so, the Tribunal considered the basis of the assessments carefully and asked for some revisions to be made. The original basis of the assessments was related to differences between the annual accounts and the VAT returns for the same periods. The Tribunal's concerns related to the treatment of debtors, as it was not clear how the accounts were produced and whether a cash basis was in operation for the VAT returns. After HMRC's representative agreed to reduce the assessments to exclude the officer's adjustment for debtors, the assessments were confirmed.

VAT Tribunal (20,828): *Pipework Systems Co UK Ltd*

6.7.3 Apportionment of food

A partnership disputed two matters in relation to food supplied by the business. By the time of the hearing, the first had been conceded: it was accepted that crepes and smoothies were standard rated. The second part related to the apportionment between standard rated "on the premises" sales and zero-rated "off" sales. The appellant standard rated only 25% of its sales; HMRC calculated the assessment on the basis of 49.56%. This retrospective assessment appeared to accept that the standard rated items could be zero-rated if sold for consumption off the premises, so it was generous in not assessing all the turnover to VAT.

The Tribunal considered that it was an unfortunate case, but the appellants had not done enough to produce an accurate apportionment. They had made an initial estimate of the split between the two types of sale and had stuck with that even when trading conditions changed. HMRC had ample evidence to support their assessment, which was confirmed as being "to best judgement".

VAT Tribunal (20,818): *Richard Jamison & Neil Patton t/a Flour*

6.7.4 Trader wins

A married couple ran a coffee shop with an old-fashioned till. They split their turnover into standard and zero-rated according to notes made on customer order slips. A HMRC officer noted that the percentage of zero-rated sales had been growing, so she carried out an exercise over several weeks and decided that the lower percentage of zero-rated turnover that she found in that period should be applied to the earlier sales.

The Tribunal took evidence from the partners and examined the basis of the assessment. Although accepting that the officer's course of action was reasonable, the chairman considered that she had failed to exercise best judgement in a number of respects. The most important of these was that the records for the test period were shown to be entirely reliable, and the traders appeared to be transparently honest. There was therefore no evidence of any suppression; insufficient consideration had been given to the possibility that there were other, innocent explanations for the changes in the split between different types of sales. The appeal was allowed.

VAT Tribunal (20,843): *Derek Andrew Dawkins and Monica Elizabeth Dawkins t/a Scandinavia Coffee House*

6.7.5 Faulty fuel pumps

A trader sold fuel from a filling station. HMRC discovered significant discrepancies between the declared sales and the readings on the "totaliser" gauges which measure the throughput of each pump "shell" (which might have several nozzles coming from it). The trader appealed on the grounds that the gauges were faulty, and it was only after receiving the VAT assessments that he realised this; the Tribunal did not accept that there was enough evidence to displace the assessments, which were made to best judgement on the basis of the available evidence.

VAT Tribunal (20,818): *Richard Jamison & Neil Patton t/a Flour*

6.8 Penalties and appeals

6.8.1 Evasion or inaction?

A company bought and sold some property on which the option to tax had been exercised. The transactions were complicated by connections between the parties and balances being recognised in accounting entries rather than reflected in cash movements, but it appeared that the company had raised a VAT invoice showing a gross sale of over £20m. In spite of this, it paid a centrally issued assessment for the relevant period for just £421. A corrected return was submitted later as a result of an investigation.

At a meeting carried out under the procedures notified to the director in Notice 730, the individual who owned and ran the company accepted that the payment of this grossly inadequate assessment, while knowing the true liability, was a dishonest act. HMRC raised a s.60 penalty on the company (mitigated by 80% to £618,803) and assessed it on the director under s.61.

The Tribunal agreed with HMRC that the word "evasion" does not require an intention permanently to deprive the Exchequer of the tax. The actions of the company were only the actions of this individual, and they would be regarded as dishonest in the eyes of most ordinary people. The appeal against the penalty was dismissed.

VAT Tribunal (20,877): *Patrick Conlon*

6.8.2 Indemnity costs

MG Rover claimed input tax in relation to goods imported to the UK, and HMRC refused. When the company appealed, HMRC issued a statement of case in March 2007 which was countered by a skeleton argument in preparation for the hearing on 28 October 2008. The Tribunal was due to commence the following Monday (3 November). HMRC delivered a new skeleton argument at 4.30pm on the Friday afternoon, now relying on entirely different grounds to deny the credit. On the Monday morning the company decided not to continue with the appeal, but it applied for indemnity costs against HMRC on the basis that it had prepared its case against HMRC's original, abandoned arguments.

The Tribunal examined the background to the dispute. The company had imported goods and been issued with C79 certificates under its deferment arrangements. Because it went into administration shortly afterwards, this import VAT was never paid. HMRC subsequently issued a "negative C79". The company argued that the import VAT remained payable (even though it would not be paid) and was therefore deductible.

HMRC's original argument was based on the concept of "unjust enrichment" (a windfall that could not fairly be expected by the taxpayer) but the company argued that this only applied to s.80 VATA 1994 claims (recovery of output tax overpaid). The last minute revision was based on the technical procedures for filing VAT returns leading up to the administration. It was contended that the liability to pay the import VAT had to be netted off against any right to recover it. There was a subsidiary argument based on the principle of fiscal neutrality: as the VAT would not be paid, it would be distortive to allow recovery of it only on the grounds that it was theoretically still payable.

The Tribunal chairman (Sir Stephen Oliver QC) commented as follows:

"*MG Rover's real criticism comes down to this. HMRC allowed them to spend fees in pursuit of a dud claim that they would have dropped earlier had the strength of HMRC's case been revealed at that earlier date. The other side of the coin is that the liquidator chose to pursue the dud claim and to run up the fees because he had failed to spot that the claim was flawed. The skeleton argument from HMRC alerted the liquidator at the last minute to something he should have known all along. But the skeleton did not cause additional costs…*

It is not satisfactory to see a case like this where HMRC have, through ignorance or oversight, failed to give a proper explanation for their decision. Nonetheless MG Rover's liquidator and advisers are professionals of equal experience and expertise. Regulation 25(3), which destroyed the claim, was there for all to see. One cannot resist concluding that they too should have recognised the weakness of their case at a much earlier time. We do not therefore see that HMRC's failure to make an application to amend their statement of case justifies a different decision on costs."

The application was dismissed.

VAT Tribunal (20,871): *MG Rover Group Ltd (in liquidation)*

6.8.3 Ordinary costs

A trader appealed against the disallowance of input tax on the purchase of a Lamborghini. Agreement was reached and the appeal was allowed by HMRC. The Tribunal had to determine what costs would be awarded to the appellant. HMRC argued that each side should bear its own costs; the appellant argued for an award of at least 50%.

The Tribunal considered HMRC's arguments – that delays by the trader had meant that the appeal was not settled as early as it should have been – and the trader's explanations – that HMRC had sent a key letter to the wrong address and therefore they were unaware that HMRC wanted particular information until a copy of the letter was found in one of the bundles for the hearing. The Tribunal decided that the trader was successful and therefore should be entitled to costs, but that a deduction would be made for failing to notify HMRC of a change of address. An award of 75% of the costs of the hearing was made.

VAT Tribunal (20,890): *6th Gear Experience Ltd*

6.8.4 New Tribunals

The Government has issued a series of statutory instruments setting out the way in which the functions of the existing tax appeals machinery (VAT and Duties Tribunal, General and Special Commissioners) will be transferred to the new Lower and Upper Tribunal. The new system is intended to be operational for hearings from 1 April 2009 onwards.

SI 2008/2833, 2008/2834, 2008/2835

HMRC have issued an analysis of technical responses to the consultation document about the new appeals process. Many of the responses concerned the new review procedure. The following is the summary section of this document:

Chapter 2: Summary

General

2.1 Most of the comments received related to the proposed review process. The responses again welcomed the statutory but optional approach adopted and concentrated on ensuring that the review was robust and in particular that it contained sufficient legislative safeguards.

2.2 There were also a number of strong but divergent views on how best to distinguish between the two stages of the direct tax appeal process, in particular over whether it would be helpful to introduce a term such as 'objection' to cover the stage at which the appeal is being considered by HMRC but is not within the jurisdiction of the tribunal.

2.3 Some respondents also raised questions about the impact of review on the ability to claim costs before the tribunal. The draft Rules of Procedure for the Tax Chamber provide for a limited power for the award of costs in the First-Tier Tax Chamber: There may, at tribunal discretion, be an award of costs where a party has behaved unreasonably, or (unless the taxpayer does not wish the appeal to be within the costs regime) where the tribunal has categorised a case as falling within the complex case management track. In cases where costs may be awarded, this is limited to those incurred once the matter is within the jurisdiction of the tribunal.

Direct tax appeal process…

Review

2.8 We received a number of comments on the legislation relating to the nature, extent and conduct of a review.

2.9 In particular we received the following comments, all of which we accept, and for which legislative provision will be made:

- *additional safeguards are needed where HMRC does not notify review conclusions within 45 days or other agreed time ("the review period") so the decision reviewed is treated as upheld;*
- *HMRC should be required to consider taxpayer representations in relation to a review;*
- *HMRC should be required to give reasons for its review decision;*
- *taxpayers, as well as agents, should be notified of any decision that affects their appeal rights;*
- *that all appealable matters should be reviewable, and that this right should not be restricted to matters for which an onward appeal right exists;*
- *for VAT, third parties who could appeal should also have a right to review; and*
- *for VAT (as for direct taxes), taxpayers should be able to discuss matters with the decision maker, without the need for review, if that is appropriate, and that they should be able to do this without prejudice to their review and appeal rights.*

2.10 In particular we accept that it is appropriate to provide an additional legislative safeguard to protect taxpayers' right of appeal where HMRC does not complete the review within the review period. The Order will contain the following provisions to cater for this;

a. requiring HMRC to notify the taxpayer that the review period has expired; and

b. ensuring that taxpayers can appeal to the tribunal from the time the review period expires (whether or not they have been notified); while

c. providing that the time limit within which they must appeal to the tribunal will run until 30 days from the date on which HMRC notify the taxpayer that the review period has expired.

2.11 In addition, we received comments that the legislation should make specific provision about the nature and extent of the review, rather than this being at HMRC's discretion.

2.12 We consider that the wide variety of decisions made by HMRC, from the automatically produced penalty notice at one end of the spectrum, to the most complex of decisions (made after consideration by a large number of Departmental and sometimes external experts and legal advisers) at the other, means that a more specific statutory definition of the extent and nature of review is not practical.

2.13 HMRC will however be setting out what a review should entail in different circumstances in guidance. Draft guidance will be published for comment.

www.hmrc.gov.uk

There is an article reviewing the new Tribunals structure in *Tax Adviser*, September 2008, as well as FAQs on the HMRC website explaining the following issues:

- *How will these reforms affect HM Revenue & Customs (HMRC) customers?*
- *How are HMRC managing this change?*
- *Why is an internal review needed?*
- *What form will the new review process take?*
- *Where is the internal review request sent?*
- *How much time is there to make a review request?*
- *What happens if HMRC fail to carry out the review within 45 days?*
- *What about differences in treatment of direct and indirect tax appeals?*
- *Can an appeal be made direct to the tribunal without having an internal review?*
- *Do customers appeal to HMRC as now?*
- *Will the circumstances for postponement of tax change?*
- *Which tax tribunals are affected?*
- *So, how are appeals going to be listed in direct tax cases which would previously have gone to the General Commissioners?*
- *When will the new tribunal system come into effect?*
- *How will the new two-tier tribunal system work?*

- *What about transitional arrangements for 'old' appeals on hand at the time of the change?*
- *How will different types of appeals be handled?*
- *What will be the costs regime?*
- *What is a Paper Hearing?*
- *Are more or less people expected to go to Tribunal as a result of these reforms?*

HMRC have promised to issue a new factsheet in February 2009 and replace the current appeals guidance on the website.

6.8.5 Successful default appeals

A company was subject to the payments on account regime. In the quarter to December 2006, the balancing payment was late and was surcharged at 2%. In the quarter to March 2007, the first payment was late and was surcharged; the second payment was a day late but a reasonable excuse was accepted by HMRC; the third payment was also a day late and was also surcharged.

The first part of the appeal succeeded: the Tribunal accepted that, following a voluntary disclosure, the company had reasonable grounds for believing that it was in credit at the end of February 2007 and therefore would not need to make a payment. It was not clear that the credit was large enough to wipe out the whole of the liability, but the genuine belief was a reasonable excuse.

The second part of the appeal was unsuccessful. The company asserted that it had not received the surcharge liability notice or extension. This was only advanced on the day of the hearing, so HMRC did not have a chance to produce its own evidence of sending the notices out; the Tribunal did not think that there was enough evidence to displace the assumption that the notices would have been served in the ordinary way.

VAT Tribunal (20,814): *Meller Group Ltd*

A company submitted its VAT returns electronically, allowing it an extra 7 days. Its return for the period ending 31 March 2008 was not submitted until 8 May, one day after the deadline. HMRC imposed a default surcharge. The company appealed, contending that it had a reasonable excuse because it had made three attempts to submit the return on 6 May, but had been unable to do so because of problems with the HMRC server. The Tribunal allowed the appeal, observing that “there is no dispute that the three attempts were made to file on 6 May, since HMRC themselves have a record of this”. The Tribunal also commented that the late filing was due to “a fault on the part of HMRC in not having the capacity to take the volume of calls likely to be made on the days when numerous VAT filings will inevitably be made”.

VAT Tribunal (20,841): *Kwik Move UK Ltd*

A company had a history of making last minute electronic payments that arrived late, and had been both surcharged and excused by HMRC in respect of past defaults. On 7 May 2008 it instructed its bank to make a CHAPS transfer at 15:51, believing the deadline for same-day arrival to be 16:00; in fact it was 15:50. The company provided HMRC with an e-mail

from the bank showing that the bank had told them the cut-off time was 16:00.

The taxpayer was not represented before the Tribunal. HMRC's counsel argued that the company had had problems with last minute payments before and should have taken more care. The Tribunal disagreed: it had checked the information with the bank and been given the wrong deadline. It had a reasonable excuse.

VAT Tribunal (20,874): *Rodcom Europe Ltd*

A company had a long-standing contract with the Co-Op to clean large numbers of its shops. A new contract was entered into in 2005: it represented some 90% of the company's turnover, and it was not profitable. Cash flow difficulties resulted, and late payment of VAT followed in three periods, October 2005, July 2006 and January 2007. The company appealed against a surcharge imposed for January 2007, contending that the circumstances leading to the shortage of funds constituted a reasonable excuse following the principles of the *Steptoe* case.

The Tribunal accepted this argument in relation to the first period of default following the start of the new contract. However, by January 2007 the company ought to have taken some action to deal with its problems, and there was no longer a reasonable excuse. The effect of striking out October 2005 was to reduce the January 2007 surcharge from 5% to 2%, so the penalty was reduced rather than cancelled.

VAT Tribunal (20,869): *Central Cleaning Contractors Ltd*

A similar result arose in a case where the excuse was the trader's marital difficulties. These were accepted – by HMRC at the hearing, as well as by the Tribunal – as a reasonable excuse for late filing of one return, but a prudent trader would have taken steps by the following quarter to ensure that the obligation was met. Again, the effect was to reduce the later surcharge, in this case from 10% to 5%.

VAT Tribunal (20,859): *The King's Arms*

A trader was perhaps lucky to find the Tribunal in sympathetic mood when pleading a typing error as a reasonable excuse. As the trader had a history of defaults arising from insufficiency of funds, he was liable to surcharges at 15%. In the current period, he had arranged overdraft facilities that would cover the VAT liability, and there was no doubt that funds were available. However, his wife, who was responsible for the paperwork, mistyped "£8,268.02" as "£268.02" in instructions to the bank to pay online. A surcharge of £1,200 resulted.

The Tribunal decided that the simple error constituted a reasonable excuse, partly because the business had made sure that it had funds available, and partly because the trader's wife noticed the error soon afterwards and corrected it immediately. It was a pure and innocent error and did not warrant such a harsh penalty.

VAT Tribunal (20,898): *Hutchinson*

A company had been surcharged a number of times and was liable to the 15% rate. It was sold to another company on 4 April 2008 because the owners wanted to make sure that they benefited from the 10% effective rate of CGT which was about to be abolished. The purchaser company

took over two other new subsidiaries at the same time. In dealing with the VAT liability of this company for the March 2008 quarter, there were difficulties with the systems for calculating the VAT and making payments, and a form went missing. As soon as this became apparent the holding company paid the outstanding amount and appealed against the resulting surcharge.

The Tribunal decided to accept the handover difficulties as a reasonable excuse, commenting: "*Whilst we accept that innocent and understandable mistakes will generally not provide a reasonable excuse for the late payment of VAT, we consider that in this case the fact that Mr. Salmon had only recently been engaged by the PHS Group and had never before had to action a payment by that company's finance department and the fact that Mr. Salmon and PHS Group were also grappling with the administrative difficulties of coordinating the systems of the three new acquisition with those of the parent company do provide a reasonable excuse for the entirely innocent late payment of the VAT. Our decision is in no way based on the fact that it would be unfair for the new parent company to suffer from the 15% rate of surcharge applicable to the Appellant and from the Appellant's own notably poor record in paying its VAT on time, but we do note that it is the very fact of the acquisition that is likely in this case to turn a poor payer into an efficient and prompt payer. It would accordingly seem slightly perverse for the hand-over difficulties that have occasioned the mistake and the late payment in this case to result in a very large penalty on the Appellant, and in substance on its new parent company, largely on account of payment failures in the past that the acquisition should put an end to.*"

VAT Tribunal (20,899): *Security Shredding Solutions Ltd*

6.8.6 Unsuccessful default appeals

A trader's main ground of appeal was that a 10% surcharge was extortionate and disproportional when he had been just one day late with his payment. Although this is doomed to fail, the Tribunal nevertheless examined the circumstances in detail and held that the trader had failed to give proper priority to his VAT affairs. He did not make enquiries with his bank about timescales and cut off time for electronic payments; a failure to reclaim VAT as input tax was his own choice; he had benefited from HMRC's concession not to enforce surcharges of less than £400. He had no reasonable excuse, and the payment had not been dispatched in time. In all the circumstances, the 10% surcharge was proportional rather than unduly harsh.

It seems that the concession had allowed the trader to believe that surcharge liabilities were not a serious matter – he found the £1,600 penalty for the "first offence" (the first penalised offence) a major shock.

VAT Tribunal (20,813): *Duncan J W Penny*

A company with two directors was late submitting its returns and payments for the quarters to July 2007 and January 2008. HMRC waived the default surcharge for the July quarter after being informed that the father of one of the directors was seriously ill; the letter accepting the reasonable excuse advised the company to make contingency arrangements to ensure that future returns were submitted on time.

The director's father died on 1 October 2007; the director said that he was involved with dealing with his father's estate well into February 2008, and his co-director was busy trying to run the business. The Tribunal expressed sympathy for the director's loss, but did not accept that the father's death could be a RE for a default so long afterwards.

VAT Tribunal (20,817): *Solution Seekers Ltd*

A company appealed against about 20 default surcharges covering the period from May 2005 to August 2007. During the hearing it dropped most of its appeals, but maintained its objection in relation to six one-month return periods. All the returns and cheques were dated well before the due dates, but were stamped as received by HMRC up to three weeks late.

A director gave evidence about the procedure for producing VAT returns and cheques, but could not produce anything to corroborate the date on which the returns had been posted. He said that he had obtained a certificate of posting for one of the periods, but it could not now be found. In the absence of any such evidence, the Tribunal had to dismiss the appeal, as the burden of proof was on the appellant to show that the returns had been despatched at a time when it would be reasonable to expect that they would arrive by the due date. On the balance of probabilities, they had not been.

VAT Tribunal (20,839): *CEL Electrical Logistics Ltd*

A pizza restaurant was late for a succession of periods and appealed against surcharges at 10% and 15%. The excuses given were a series of variations on "insufficiency of funds" and "harshness of the penalty", neither of which can constitute a reasonable excuse. It appears that the Tribunal chairman was particularly unimpressed because the trader was a retailer – it would already have received all the proceeds of sale, including the VAT, and should have put the money aside to meet its liabilities as they fell due.

VAT Tribunal (20,878): *Heavenly Investments Ltd*

A trader asserted in correspondence that the reason for late payment of VAT was the absence through serious illness of the only two people authorised to institute a payment. The Tribunal commented that this could constitute a reasonable excuse, but as there was no corroborating evidence of the illness, and the trader did not appear before the Tribunal, it was not possible to uphold the appeal on those grounds.

VAT Tribunal (20,873): *Impact Services Ltd t/a Ecoclean Franchise*

A company succeeded only to the extent that one of the surcharges had been overstated by HMRC. Its excuse – that the finance director, now departed, had been responsible for the failures – was ruled to be excluded from what is "reasonable" by s.71(1)(b) VATA 1994 (reliance on another).

VAT Tribunal (20,892): *Max Security Ltd*

A company had been in default for 13 periods, 10 of them at the 15% rate, incurring total penalties of about £25,000. It was 6 days late in paying a 14th liability and was penalised again. It pleaded insufficiency of funds arising from difficulties in trading, but could not produce any evidence to

show that there was a special circumstance that would allow the application of the *Steptoe* principle.

The Tribunal chairman commented:

We should comment that the Appellant had complained to its MP, Mr. Peter Hain, in respect of the relevant surcharge, and Mr. Hain had passed on the letter of complaint to the Chancellor of the Exchequer. Predictably this resulted in a letter of explanation from HMRC in which it was explained that the law had been correctly applied in this case and that it would be wrong, in terms of fairness to other taxpayers, for any different treatment to be accorded to the Appellant. We entirely agree that in terms of the present law, this response from HMRC was correct, and that the Appellant has no complaint against the officers of HMRC who have applied the law in the present case.

VAT Tribunal (20,896): *East West Demolition Ltd*

A company had major difficulties with its accounting system because its financial controller had "thrown her keys on the table" and left after a clash of personalities with the managing director. The next VAT return was submitted and paid late, and the company pleaded a reasonable excuse because it had not been able to access its computerised accounting records for some time.

The Tribunal found that the company's external accountants had in fact managed to compile the VAT return before the due date, and there was no reasonable explanation for the failure to file it on time. The company had apparently had some difficulties with the online filing system on 6 August 2008 and had consulted the helpline, but had failed to make a CHAPS payment on that date to avoid the possibility of a surcharge.

VAT Tribunal (20,897): *Vent Air Systems Ltd*

6.8.7 Updated default notice

HMRC have issued an updated version of Notice 700/50 Default Surcharge. The paragraph "what's changed" explains as follows:

Para.	*Details*
1.3	New paragraph setting out legal references.
2.1	Now includes information about what happens if 'nil' or repayment returns are submitted late.
2.2	Clearer advice on how to avoid a default when due date falls on a weekend or bank holiday.
2.3	New paragraph setting out requirements for businesses in the Payment on Account (POA) scheme.
2.4	Inclusion of telephone number for Large Payers Unit. Details of what will happen if we agree to defer payment.
3.2	New paragraph outlining concessions for small businesses.
3.4	Paragraph heading changed from 'Payments on Account' to 'How is the surcharge calculated on POAs?'
3.5	Clearer advice on when a surcharge will not be issued.

3.7 Clearer advice on what happens when you have an agreement with us to defer payment or you pay by post-dated cheques.

6.1 Changes to the turnover amounts for inclusion in the Cash and Annual Accounting schemes.
Further details on payment by electronic transfer.

VAT Tribunal (20,817): *Solution Seekers Ltd*

6.8.8 Late filing consultation

HMRC have issued a second consultation document on late filing penalties. The whole system of incentives for timely filing is being reviewed across all the taxes. HMRC recognise that there are different issues where there are regular and frequent filing and payment obligations (PAYE and VAT) as opposed to annual or irregular filing (most direct taxes and transaction-based taxes).

The following comments on VAT were raised in responses to the previous consultation (June 2008):

3.35 The current VAT default surcharge system was examined and its benefits and limitations explored. Possible adaptations to the VAT default surcharge were considered, notably separating the response to late filing from late payment – in effect splitting the surcharge in two, by introducing an initial fixed penalty and a penalty for prolonged non-filing/payment. The consultation document acknowledged that care would have to be taken to ensure proportionality.

3.36 It was suggested in the consultation document that some of the taxes with frequent filing obligations, for example excise duties and environmental taxes may be better suited to an approach similar to that for annual obligations. In this approach each filing obligation would be treated as distinct resulting in a sequence of fixed and tax geared penalties for each monthly return period, escalating the longer the return or payment was outstanding.

3.37 The consultation document asked a number of questions about how the models could be adapted for frequent obligations and how the proposals met the design principles. A number of respondents felt that the penalty regime for frequent filing was too complex. One respondent with a particular interest in VAT pointed out that where a VAT return was filed late then inevitably the payment would be late thus indicating only one misdemeanour. The respondent also suggested that penalties for late filing should not apply where the return resulted in a repayment; however they accepted that persistent late filers should have penalties imposed. Where a VAT repayment was due it was suggested that a fixed penalty would have to be imposed for late filing as there was no tax liability to calculate a tax geared penalty.

The Government is currently considering a "penalty model" along the following lines:

- distinguishing late filing from late payment;
- operating separate penalty regimes for each, possibly similar to the "surcharge liability" procedure currently in use for VAT;
- late filing will suffer fixed penalties while late payment will suffer tax-geared penalties;

- the first late payment will only incur a warning that a penalty will follow the next late payment in the liability window, but the first late filing will incur a penalty;
- penalties to rise for successive defaults, as for default surcharge;
- tax-geared penalties also to rise for extended failure (it is noted that there is currently no difference in VAT surcharge between a day late and a year late).

www.hmrc.gov.uk

Draft legislation and technical comments have also been published on 12 December 2008.

www.hmrc.gov.uk

6.8.9 Misdeclarations

A trader appealed against an assessment for £86,625 and a s.63 penalty at 15%, mitigated by 15% to reflect the trader's good compliance record in the preceding 3 years. The error was a failure to account for output tax on the sale of some opted land.

The trader claimed that he had made a voluntary disclosure on form 652. However, this had been sent to VAT Central Unit, not to the Local VAT Office as required on the form. It was therefore not in accordance with reg.35 SI 1995/2518, which requires that errors should be corrected "*in such manner and within such time as the Commissioners may require*". The Tribunal considered the nature of the trader's business, which involved only a few large transactions a year, and decided that it was a relatively straightforward matter for VAT: he had claimed input tax but had forgotten to account for output tax, and he had not corrected the error in the manner prescribed. The assessment and the mitigated penalty were confirmed.

VAT Tribunal (20,893): *Richard Sadler t/a Warmfield Group*

Another recent case offers an interesting contrast. An individual, who was also a VAT-registered trader, engaged a builder to do some work on his house. The builder charged 17.5% VAT, which the individual disputed. HMRC later ruled that the 5% applied, but the builder failed to make a refund to the individual. He then claimed the difference back as input tax on a VAT return, explaining what he had done in a covering letter sent with the return. HMRC imposed a s.63 penalty for the obviously incorrect claim.

The Tribunal chairman ruled that the disclosure of the facts fell within s.63(10)(b): there could be no misdeclaration penalty because the trader had given full details to HMRC before they had discovered the error. Although the return was wrong, there could be no misdeclaration penalty as well. If he was wrong on this point, the chairman thought that it was one of those rare occasions when 100% mitigation should be allowed under s.70.

It appears that the individual has now recovered the VAT, although it is not clear whether this was through the builder or directly from HMRC.

VAT Tribunal (20,895): *Alan Boffey*

6.9 Other administration issues

6.9.1 Complaints

HMRC have issued a new factsheet on “Complaints and putting things right”. It sets out the appropriate procedures for making a complaint and the various possible responses that may be expected from HMRC.

www.hmrc.gov.uk/factsheets/complaints-factsheet.pdf

6.9.2 Disclosure of schemes

HMRC have issued new guidance on the rules for disclosure of direct tax avoidance schemes. This appears to be one of the few areas in which the old “Inland Revenue” and “Customs & Excise” have not yet been combined: the rules on disclosure of VAT schemes are still covered by separate guidance in VAT Notice 700/8.

www.hmrc.gov.uk/aiu/disclosure-nov08.pdf

6.9.3 Extra-statutory concessions

Following the *Wilkinson* case, the authority of HMRC to make ESCs has been called into question. FA 2008 included a power to legislate for existing ESCs to resolve their status. A technical consultation document on draft legislation has been issued, including the following concessions relevant to VAT:

- 3.12: VAT: Buses with special facilities for carrying disabled persons VAT.
- 3.36: VAT: Imported works of art, antiques etc.
- Relief for goods supplied for consumption on board intra-Community rail journeys departing from the UK VAT.

http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageExcise_ShowContent&propertyType=document&columns=1&id=HMCE_PROD1_028967

6.9.4 Security

As usual, no appellant has succeeded in dislodging a notice requiring security.

VAT Tribunal (20,812): *Neilson & Co*; (20,856): *NEC Engineering Ltd*; (20,857): *Mackquail Company Ltd t/a The Green Man*; (20,885): *Swanwick Civil Engineering*

6.9.5 Online guidance

HMRC have published updated online guidance on the debt management and banking. It covers a number of issues across all the taxes: in relation to VAT, it only refers to “chasing immature VAT debts”.

www.hmrc.gov.uk/manuals